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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

November 2, 2010
1:00 p.m.

Minutes

I. Call to Order and Roll Call at 1:05 p.m. (Ken Johnson, Chair)
Present: Johnson, Durcan, Oemichen, Sheehy [by phone], Wolff, Schlissel, Sarah Henriksen, Shane Martwick, and Tom Biwer (all Wells Fargo, by phone], and Jim DiUlio.

II. Agenda Approval and Public Posting Report (Chair, staff)
Approved by unanimous voice vote.

III. Approval of Committee Minutes for September 7, 2010
Accepted and motion by *Oemichen*, second by *Durcan* to approve. Carried.

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

V. Old Business

A. Update on program contract. Wolff reported that DOA and Wells Fargo have agreed to an 18-month extension of the current contract expiring in May 2011. This leaves two three-year extensions available. He added that we are currently happy with Wells Fargo's service to the program and do not have pending plans to rebid the contract, but the timing of the extension will help determine if are getting the best value for our investors.

Included with the agreement will be the ability to add up to three indexed portfolios as additions or substitutes. The fee reductions that came about with Wells Fargo's purchase of Evergreen are also noted. Wells Fargo's offer to waive the $10 fee for the tuition unit accounts is appreciated. Because of the time involved to combine or reconfigure the advisor version of EdVest with Tomorrow's Scholar, *Wolff* felt it was not fair to ask for all that work within the extension period.

Wells is also happy to continue working with the Board, *Henriksen* added, and can begin the new investment process soon. They decided to waive the tuition unit charges as of this month.

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Johnson extended his thanks to all who worked on the agreement. In a discussion as to the timing of the extension's end, *Wolff* said that 529 consultant Andrea Feirstein felt with a number of other state contracts opening at that time, we will see some price discovery then. What DOA feels is a fair deal now could become better. *Oemichen* stressed that the record show that this was a deliberate strategy and not just a no-bid extension. With the contract extension going to October 30, 2012, an RFP process if needed would have to start less than a year from now, in the summer of 2011, assuming a 6 month procurement process and 9 month transition.

B. <u>Timetable for reviewing new program investment choices</u> *Johnson* suggested that in view of the recent agreement, the committee request that *Schlissel* and EAI evaluate the choices proposed by Wells Fargo's offer in April. He said he liked additional index funds. He also related email conversations with *Sheehy* and *DiUlio* regarding ETFs as a choice. Wells Fargo's proposed additions included an international index fund, a fixed income index to replace current fixed income choices, and a small cap index portfolio to complement and/or replace the Legg Mason fund. Replying to *Johnson's* question, *Henriksen* said that they felt these still were good choices, and could also include some adjustment to the age-based portfolios.

Schlissel stated that she would review the SSgA choices suggested along with others as part of her due diligence work. She will also look at various share classes and fees.

Biver said that he would like to also review the mixes of the age-based portfolios, suggesting some gaps exist in the risk spectrum. *Schlissel* replied that those adjustments would be welcome anytime. Feel free to do so, *Johnson* added, along with any suggestions for program choices we have not discussed.

Referring to last December's client survey, *Johnson* said that emerging markets were the third most mentioned item on the client survey, just after index and international funds. He asked *Schlissel* to also identify funds in that category that may work for us.

Sheehy asked if ETFs could also be included in the review, referring to an article in one of the investment trade publications. *Schlissel* replied that her recent work with another state found that ETF investments are very complicated and it would be wise to proceed carefully. She said that ETFs have higher fees, involve brokerage accounts, interday trading, and the benchmarks are not clear. *Durcan* asked if there is a demand for them in other 529s. *Schlissel* answered that in the other state, ETFs took the place of index funds, and the demand so far is low. A question could be raised to offering both types of portfolios, ETFs and index funds, or only one. *Wolff* added that his earlier interest in ETFs has reversed as reports of price manipulation have surfaced, and entire concept could create a disclosure issue with the public, generally used to mutual funds only. He also brought up another disclosure concern in that the SSgA proposed portfolios are common trust funds and not mutual funds, specifically if they are subject to the same level of SEC disclosure. *Schlissel* said she would explain the differences in her report.

C. <u>Update on Credit Union CD portfolio</u> *DiUlio* began the discussion, reporting that he recently spoke with Russell Moore of the capital markets group at NCUA's headquarters in Virginia. Moore was not fully aware of our relationship with Members United FCU nor our earlier requests for information through the NCUA regional office in Texas. He also informed Moore that we had heard that individual credit unions had been reluctant to work with Members United due to its financial difficulties. Moore was also surprised that nearly all of our placements through Members were with the smaller CUs and none of the large state institutions. Recognizing the situation and our client base, Moore said that we would be among the first to know if Members United would be resold to another CU or if it would be dissolved.

Henriksen continued, reporting that as of October end, just over 69% of the CU portfolio remains uninvested in cash, up from about 63% at the time of the September 13 Board meeting. She said that Wells Fargo still has a good relationship with Members United, and Balance Sheet Solutions, but with no local CUs interested, the focus is on renewing certificates at maturities. While continuing to work with Members, she and *DiUlio* have been in discussion with *Bill Sayles* of Corporate Central Credit Union as an alternate channel. There may be some modest interest through CCCU's network, perhaps one or two CUs, *Henriksen* said, but there is little need for liquidity with the low level of loan demand. *Sayles* told her that a number of credit unions do not accept nonmember deposits, even if they are public deposits. Another obstacle with the larger institutions may be the $250,000 limit. *Sayles* has been invited to attend the Board's meeting next week.

What would be the procedure, *Oemichen* asked, if our best efforts to place client money with credit unions were unsuccessful but we placed them at a bank? *Henriksen* said that process would require legislative changes. Due to the fact that each trust limits deposits to each channel, statute would prevent this action. *Johnson* added that we are not required by law to have a credit union option, with *Henriksen* agreeing. *Johnson* also suggested that if we were to take action to close the CU portfolio, it could be part of the larger fund lineup change.

The committee discussed the progressive disclosures on the EdVest website regarding the level of CD invested funds. In the event of unwinding the CU portfolio, *Henriksen* suggested closing the portfolio to new money immediately and then a 60-day window to default to the bank portfolio. The default would not burn the once per year 529 change, however another choice by an investor during that period would. For perspective, Henriksen said that the CU portfolio gathering only $7 million in two years is not as popular a choice, about half of that of the bank portfolio. *Oemichen* asked the committee to be aware of the public statements of credit unions vs. banks that come up from time to time. *DiUlio* asked why the credit unions were reluctant to take public funds deposits. *Henriksen* related that there is nothing to prevent that, other than internal rules as some institutions. Perhaps they would make a nonmember exception for us. *Johnson* asked if we decide to close the portfolio in February, do we ask for a legislative change? *Oemichen* said he was reluctant to just close one portfolio, but try to find a mechanism to allow placement with the other. The CU portfolio could just be closed to new money, *Henriksen* offered, waiting for the markets to improve. Whether to close to new investors or new money from existing investors, as well, should be considered.

The committee also wondered if the large institutions could have been approached differently, other than through their CU League or Members United. CCCU may have better links to the leaders. Some discussion followed on Wells Fargo's contract with

Members United, which could be ended on short notice, opening the door for another provider. There would be nothing to limit working with both CUs during a transition.

Motion by Oemichen, second by Sheehy, to recommend to the College Savings Program Board that Wells Fargo be directed to move the credit union CD portfolio business from Members United FCU to Corporate Central Credit Union. Approved by unanimous voice vote. Carried.

D. Review of 2010 Morningstar 529 Research Paper and Industry Survey *Henriksen* began the topic saying the release of Morningstar, Inc.'s 51-page report last week was somewhat disappointing, the headline news was that the EdVest plan was rated average, and the Tomorrow's Scholar plan was rated below average. Their narrative section, available to Morningstar's premium customers, was not flattering again this year. In spite of the efforts by Wells Fargo, Board members, and director to deliver consistent messages with Morningstar's interviewers, it didn't seem to have much impact, *Henriksen* said.

Although it is not Wells Fargo's policy to respond to a rating agency's opinions, in Morningstar's case there are a number of data inaccuracies that cannot be ignored, perhaps leading to the ratings. She said that Wells Fargo has contacted Morningstar verbally and will follow with written information, that in the best case, will cause them to adjust their data and correct the ratings. As an example, the report's published performance numbers, with the exception of the two bond portfolios, that were considerably less than actual performance, for one-, three-, and five-years. *Schlissel* asked where these erroneous numbers came from? *Henriksen* said that in the past, Morningstar could have created their own versions of multifund portfolios rather than using the actual security's performance. Both Vanguard Balanced and Legg Mason's Morningstar numbers are significantly off from actual performance, *Schlissel* added. *Sheehy* remarked that a 4-5-6% discrepancy in a calendar year is shocking, how could Morningstar make that mistake?

The total asset numbers for both of our plans and the industry total were overstated, which could affect relative numbers. *DiUlio* said that Morningstar issued a press release yesterday admitting that some portfolios in some plans were counted more than once, but the numbers in the report were not corrected. He also noted that on Morningstar's current website, the expenses listed for the same funds in both the EdVest direct and advisor-sold versions were at the higher advisor rate. Using their own numbers, this would affect our direct plan with other direct plans. Morningstar also missed our weighted average net expense ratio on the direct plan, which is less than some of their very top rated plans, *Henriksen* said. *Sheehy* asked why the omission of the direct plan's expense number. She is perplexed, since Wells Fargo took considerable time during the pre-interview time to provide a full set of expense numbers. A number of similar discrepancies have shown up in other states, *DiUlio* said, including one state with identical in-state and out-state versions; one received the top rating, the other was ignored. We were contacted by Investment News, a trade publication, for reaction and *DiUlio* told them we have no comment now, but the channel is open if we need it later.

Johnson asked if Wells Fargo has responded to Morningstar regarding the data discrepancies. *Henriksen* said that the information is being assembled for a letter from one of the fund company's senior leaders, with the message stressing data accuracy, not questioning Morningstar's right to an opinion. A short discussion followed, concluding that initial contact should come from Wells Fargo rather than the Board.

Durcan asked if our program has received any public comment or reaction. *DiUlio* said there has been no response received at the office, and a scan of state and national news websites during the week since the report has been released comes up negative. Wells Fargo's *Tom Biwer* had one final comment concerning the misreporting of the 2008 returns, in correctly affecting the final rankings. It would be a significant move if the returns were corrected, meaning that four of our nine tracks would place in the top ten. And the average of all the tracks would move up 20 places out of 80, a very significant discrepancy. *Schlissel* suggested that we proceed carefully, trying to work with Morningstar to correct the technical errors.

E. Third Quarter 2010 Investment Performance Reports The EdVest returns for the quarter were good, *Schlissel* said, as she took the committee through EAI's report. We continue to see improvement on the one- and three-year periods, and 11 of 12 of the enrollment-based portfolios outperforming the peers; same with static funds. The underlying funds are the best they have been in some time--generally a good report. As an example, the enrollment-based peer chart on page four now show fewer red numbers as the portfolios rise among their peers, a great improvement from a few years ago.

As with the Tomorrow's Scholar plan, 11 of the 12 enrollment-based portfolios outperformed on the one- and three-year periods, and seven of seven of the static choices. A little more variability on the underlying funds chart.

Three things on the management front: Sam Peters has been named a manager of the Legg Mason Aggressive Fund. At Harbor, Hakan Castegren passed away, although he was in semiretirement and a full team is in place. And at the Columbia Marsico Growth Fund, a second manager has been named to work alongside Tom Marsico.

F. Watch List Update, Review, Recommendations to Board, Recommended changes, additions, or deletions One of the watchlist criteria is four consecutive quarters for three-year rolling, so we put three on early warning, WFA Capital Growth, WFA Diversified Small Cap, and Columbia Marsico Growth. The only fund continuing on formal watch is the WFA Diversified International because of a management change, but its performance numbers are improving. *Biwer* pointed out a few fund name misprints following some fund mergers. Copy will be corrected for the Board meeting

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

VI. New Business

The subject of inviting fund managers to meet with the committee was raised. *Schlissel* suggested we invite WFA Diversified International Fund for a 10-15 phone meeting in May. *Biwer* suggested Jeff Whitmoyer, who succeeded Brian Jacobson, and could also invite a team member from one of the underlying managers. He will make arrangements.

Sheehy asked if the Board had an obligation to make a public announcement about the contract extension. Wolff said an additional announcement is not necessary, it is a prerogative of DOA and a reasoned decision. The mention in meeting minutes is sufficient.

VII. Future Committee Agenda Discussion Items

CCCU's role will come up again as the relationship develops.

VIII. Announcements

NEXT MEETING: The committee discussed possible meeting dates in February 2011. Monday the 7th became the tentative date, with a 1:00 p.m. start, assuming the full Board will meet on February 14.

IX. Adjournment

<u>Motion by Oemichen, second by Wolff to adjourn. Unanimous voice vote. Meeting adjourned at 2:26 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.***