Minutes of the Meeting
of the
College Savings Program Board

Held in the State Treasurer's Conference Room, Fifth Floor
1 South Pinckney Street
Madison, Wisconsin

October 30, 2006
1:00 p.m.

MEMBERS PRESENT: *Adamski, Darling, Johnson, Wegenke, Durcan, Oemichen, Voight, and Reid. By Phone: Sheehy*

MEMBERS ABSENT: Cook, Plale

OTHERS PRESENT: Marty Olle and Rich Janosik, EDVEST Program; Tom Petri, Sen. Darling's office; Andrew Owen, Nancy Galica, Sarah Henriksen, Tom Biwer, Wells Fargo Funds Management; Michael Wolff, DOA; Ron Jackson, Linda Schlissel and Kathy Bajorinas, EAI (by phone); Rachel Shikoski, LAB; Matt Tomasicchio and Susan Lowe, KPMG LLP (by phone)

I. Call to Order – The meeting was called to order at approximately 1:07 p.m. by Board Chair *Darling.*

II. Roll Call – See above.

III. Approval of Agenda –

IV. Public Presentations - None

V. Approval of Minutes – *Oemichen* moved and *Reid* seconded a motion to approve the minutes of the June 12, 2006 meeting of the Board, as distributed. *Olle* mentioned a typo in the minutes stating a Board meeting date as June 30, 2007, which should be July 30, 2006. The members making the motion to approve accepted the change. Motion passed on a voice vote without objection.

VI. Administrative Reports

A. Board Chair Comments – *Darling* reviewed the major goals of the meeting; to hear the auditor's reports on the annual audit, review portfolio changes recommended by Wells Fargo and review second and third quarter investment performance.

B. State Treasurer Comments – *Voight* reviewed the activities of Higher Education Day in Wisconsin, which was held on October 3. It was a new beginning for outreach for the program and it was a good start for the event's first year. He displayed the joint proclamation signed by all constitutional officers of the state. The mission of the day was to raise awareness state-wide of the importance of higher education, to inspire students to obtain a higher education and families to save for higher education, and recognize educational leaders in the state. Each officer took a different sector of the state, and events were held in Appleton, Stevens Point, Eau Claire, and Milwaukee. The website will be kept up and expanded for next year. *Voight* thanked all the partners who participated in the event this year.

Darling asked for unanimous consent to skip to Item VIII A. under New Business on the agenda. She turned the meeting over to representatives from KPMG, Matt Tomasicchio and Susan Lowe, to review the annual audit report for the program. The Board agreed to do so without objection.

VIII. A. <u>Independent Auditor Report – Financial Audit for Fiscal Year 2005-2006</u> -- Audit partner Matt Tomasicchio and audit manager Sue Lowe reviewed the audit results for the Board and the presentation materials prepared for the meeting. He reviewed the process for auditing the 17 portfolios that are the subject and scope of the audit, including the two new offerings, the Wisconsin Select Portfolio and the Tomorrow's Scholar Stable Value Portfolio. The agreed-upon procedures requested by the Legislative Audit Bureau should be completed shortly. He summarized the results as very favorable, and they received good cooperation from management and all service providers. The audit report is an unqualified opinion. There were no disagreements with management on financial accounting or reporting matters, and there were no limitations placed on the scope of their procedures.

KPMG verified the existence of the holdings and independently valued the holdings in the portfolios. They assessed internal controls at the plan and the servicing agents. They did not identify any material weaknesses or significant deficiencies in internal controls. They reviewed all disclosure materials and found them to be in conformity with generally accepted accounting principles. He commented on the robust disclosure in the audit of changes in the Financial Accounting Standards Board [FASB] position regarding valuation of investments in the stable value portfolios. He confirmed independence of the auditors, and reviewed audit communications that are required for public companies. He reviewed the representations letters made by management, and that there was nothing noted that was out of the ordinary during their audit process. He noted that there was no need for an executive session with the Board, although he stated his willingness to have one for the Board if anyone desired to do so.

Johnson asked whether the scope of the audit included any measure of compliance with any of the outside funds being used in the program or any SEC issues or irregularities that may exist for the funds. Tomasicchio replied that the scope of the audit did not include any testing of, for example, Vanguard's own disclosures of any irregularities that had been disclosed by their auditors. This could be included as a part of the scope of KPMG's work, but generally would be the responsibility of Vanguard's auditors' due diligence for that fund, or the investment managers requirement to disclose these irregularities to the program staff. KPMG would be spending additional time if the auditors felt that there were issues that needed further investigation but he was not aware of any, and Henriksen also stated that all the Wells Fargo agreements with funds they are using in the portfolios require disclosure to Wells of any problems that are disclosed to them. *Wegenke* suggested that if anything of this nature comes to staff attention, that the Board should also be notified as well as Board policy.

<u>*Wegenke* moved that if there are regulatory or other questionable practices that the Program Manager brings to the attention of program staff, that the Board also be notified of such issues. *Adamski* seconded the motion. Motion passed by voice vote</u>.

Oemichen asked if KPMG audits any other state 529 plans. Tomasicchio replied that they did audit other state plans but he was not personally involved in other 529 audits. He communicates with other KPMG partners that stay current with industry practice in the area. *Oemichen* asked if the audit scope would be any different for other state 529 plans, and Tomasicchio stated that they would not be performed any differently, but would conform to KPMG standards. Schlissel commented that this audit was similar to the audit performed for the New York State 457 plan, in that activities of outside fund managers are the responsibility of their outside auditors to bring to the attention of the Program Manager, whereas the program audit tests that the balances are correctly being recorded.

Olle asked Tomasicchio to comment on the Stable Value disclosures on page 7 of their report, and asked him to comment further to bring the Board up to date from last year's audit comments. Tomasicchio stated that the disclosure footnotes for Stable Value refer to the FASB accounting recent position on who could continue to use "contract value" accounting for stable value funds. 529 programs were not included in the permission by FASB to continue to use this type of accounting but now would have to be accounted for by "fair market" accounting, which would likely mean a fluctuating NAV going forward from July 1, 2007, instead of a stable NAV. He said he had discussed this with other KPMG partners on other 529 plan audits that are transitioning away from stable value for this reason.

> *Oemichen* moved to accept the audit report, seconded by *Voight*. Motion passed by a voice vote with no objections.

VIII B. Stable Value Investment Portfolios Update and Plan -- Henriksen and Owen of Wells Fargo presented the board with a report including a timeline for moving away from stable value to another investment product. FASB has now come out with a formal staff position paper prohibiting contract value accounting that will force 529 plans make a change. She discussed three possible options, including valuing the "wrappers" at fair market value, converting to GASB accounting, and modification of the investment policy to use a different investment product. The only viable option from Wells Fargo's point of view is the third option, as the first would violate the stable NAV that currently defines the product, and the second may only be a short-term solution as it is thought that GASB will also eventually conform to the FASB position on this product. *Voight* asked a question about other states, and Henriksen reported that other states are either moving away to other investment products or, in the case of Ohio, adopting Governmental Accounting Standards Board (GASB) accounting.

Wells has been working with Galliard, the sub-advisor for the Stable Value Portfolios, who are confident that they can narrow the gap between the market value of the portfolio and the contract value of the portfolio to zero by the end of the fiscal year so that there would be no loss to the plan investors. Currently, the gap is approximately $500,000. The other step is looking at other investment options and bringing a recommendation back to the Board in January. *Johnson* asked if this is having any impact on the amount being invested in stable value; Henriksen stated that the inflows result from it being a part of the age-based portfolios and the impact has been minimal. The interest rate environment is allowing the gap to be narrowed over time. The spread between the earnings rate on the portfolio and the crediting rate is being used to narrow the gap.

VIII. C. 2006 Third Quarter Investment Performance Review -- Ron Jackson of EAI led the discussion of portfolio performance for the program. He stated that they look at performance portfolios versus benchmarks, then the performance of the underlying mutual funds and finally peer group comparisons. He started with second quarter performance, as the third-quarter peer universe comparisons are not available yet. He reviewed the materials prepared for the Board members. Four of the five EdVest age-based portfolios have ranked very well in the three-year rankings versus their peers. The static portfolios are measured against peers that are also static, and do not change by the age of the beneficiary.

The static EdVest portfolios have not ranked as well as the age-based comparisons, although the bond and stable value portfolios have ranked well. The non-Wells portfolios have done well, especially the Vanguard funds versus their peers. The Legg Mason fund has not done well due to poor performance in the second quarter, although it has very good long-term performance. All in all, the EdVest portfolios are doing well against their peer groups. *Oemichen* asked for clarification of the comparison with benchmark and with peer groups. Jackson stated that EAI is finding that it is important to look at both, because while the fund or portfolio may be underperforming against its benchmark, it may be doing well when compared with other similar investments in other 529 state programs; its peer universe.

For the *tomorrow's scholar* program, the EAI comparisons are to "A" shares of other programs. Jackson commented that the TS portfolios have had problems compared to their benchmarks, as well as underperformance when compared to their peers. He reviewed the data presented for the TS program. The concern is that the age-based portfolios are not performing well against the peer comparison, but the static portfolios have done somewhat better. He noted that some of the universes used for comparison are relatively small, and that there have been some changes in the make-up of the funds. *Johnson* asked whether the underperformance is being driven by returns or the fees charged by the program for the offerings. Jackson said he would address that issue when presenting the 3rd quarter results.

He then discussed the 3rd quarter performance data for the EdVest portfolios. All portfolios rose during the quarter, but generally the non-Wells funds did better than the Wells funds. The Wells Growth fund contributed to underperformance of several portfolios, while the bonds funds did better. He commented on the geometric year-to-date column on the charts. Schlissel commented that the more positive values in that column, the better. Underperformance in the two Wells growth funds have resulted in poor performance for the portfolios overall, because of their exposure to these underlying funds. *Johnson* commented that underperformance compared to benchmarks for the actively managed funds in the portfolios demonstrates the management fee brings the performance down and argues that investors might be better off just investing in index funds. He also stated that focusing on one quarter results are too short and the Board really should be looking at three-year results, at least. Jackson agreed that the quarterly analysis, although relevant, should not take attention away from looking at the longer track record of the funds and portfolios.

The *tomorrow's scholar* funds and portfolios, in almost every period, are trailing their benchmarks. Jackson discussed the underperformance of the RiverSource and other outside funds. Fixed income funds are keeping in line with the benchmarks in these portfolios. Jackson stated that the Wells proposals for changes in the portfolios will be addressing some of the problems that are identified by this analysis.

Olle commented that going forward, the peer comparisons will only be presented at the April Board meeting, and at the other meetings there will be a brief report on the performance versus the benchmarks for the funds and the portfolios. Any "watch list" discussion, when necessary, will be done in closed session. Jackson mentioned that the monitoring of potential "watch list" investments according to the Board's investment policy would begin in July of 2007 due to the need to monitor the rolling averages for four quarters.

VIII. D. <u>EdVest and *tomorrow's scholar* Investment Portfolio Changes</u> -- Owen, Henriksen, and Biwer of Wells Fargo presented materials that were distributed to the Board regarding proposed strategic changes to the portfolios. Owen discussed the purpose of the proposals, focused on the equity portions of the portfolios, is to make reallocations. There is an increase in international exposure, increased manager diversity, and adding direct exposure to the small-cap style by the reallocations being proposed for EdVest. For the *tomorrow's scholar* portfolios, there is a replacement of several of the funds to attempt to improve the performance that have lagged. There is an additional benefit to these changes, in that the fees are being reduced for the portfolios that are being adjusted due to lower expense ratios of the replacement funds. Jackson stated that EAI had reviewed the recommendations and supported the changes for the reasons stated. *Voight* asked when the changes would be implemented. Owen stated that before year end, when new disclosure documents go out to all investors, the changes will be reflected. *Adamski* asked how often recommendations of this type would be made. Owen stated that this would not be done often, and believes that these portfolios are long-term portfolios and they will not be making frequent changes.

He said that working with EAI, the changes had been reviewed and analyzed. *Johnson* suggested that an analysis of relative change based on a comparison of the current and recommended portfolios would be helpful. *Voight* suggested that the public also needs an explanation of why these changes are being implemented at this time. *Darling* asked that Wells Fargo state that these recommendations represent their best attempt at improvements to the portfolio structures, as well as confirmation from EAI that they concur that this will be the impact of the proposed changes. Schlissel and Jackson confirmed that they had analyzed the proposals thoroughly, both in terms of the asset allocations and the risk/return result, and the changes of underlying fund managers in the proposal. Much of this background work was discussed at length with Wells Fargo and state staff, but is not necessarily reflected in the materials being presented at the meeting today.

Biwer was asked to comment on the changes in asset allocation. He stated that while a statistical analysis might not show exactly the numbers reflected in the proposal, these changes to asset allocation are in the mainstream of what other programs and like-investments are doing at this time given the current investment environment.

Adamski stated that it was more important that the Board be assured that they were getting good advice from EAI on the changes to the portfolios. Jackson reviewed the process that they used to test the recommendations that Wells Fargo had presented. He talked about the analysis of the asset allocations, the managers who are being recommended, and the potential results of the changes. They felt that there were also improvements to changes in share classes in terms of lower fees for the program. He felt that this transition was carefully and deeply thought out, and EAI concluded that the changes make a lot of sense. *Voight* asked about whether EAI had recommended any changes to the proposal, and Jackson related several instances where Wells Fargo has taken a suggestion of EAI and incorporated it into their presentation. *Johnson* asked that EAI provide a letter that would comment on the Wells Fargo proposals, the process they followed and indicate their position on them. EAI stated that this would be provided to the Board.

> <u>*Adamski* moved to approve the Wells Fargo portfolio changes, subject to getting a memo from EAI supporting the recommendations. *Durcan* seconded the motion.</u> *Wolff* asked about the percentages of Wells Fargo funds and non-Wells Fargo funds after the portfolio allocations would be implemented. Owen and Biwer stated that the percentages remain virtually unchanged. <u>The motion passed by voice vote.</u>

Adamski asked that the staff report back to the Board as to the length of the EAI contract, and when it would be renewed. *Olle* stated that the contract is for a maximum of five years, and we're entering the third year of the contract. It can be cancelled by either side with a 30 day notice. He would expect that it would be re-bid after the five year term has run out.

VI. C. <u>Administrative Reports; Program Director Comments</u> -- *Olle* stated that a couple of funds have requested consideration to be included in the offerings of the program, the Monetta Fund from Illinois and the Appleton Group from Wisconsin. He related the process that the staff follows when we receive such requests. He also stated that an investor had asked the program to terminate the Stable Value Portfolio in favor of a money market fund. He discussed the comments made about the program on the Clark Howard radio program, and stated that we have tried unsuccessfully to get in touch with him to discuss why he does not recommend the Wisconsin program to his listeners. Several articles concerning college savings and costs were distributed to the Board. *Olle* reported a drop-off in the last quarter in the number of open accounts. This should be labeled net open accounts. The number of new accounts opened has not changed significantly, but the number of persons using their accounts to pay for college expenses has jumped noticeably and many accounts were closed this quarter after paying for expenses. The graph titles will be adjusted reflect more accurately what is happening in the data.

Olle reported that the Strong settlement distribution plan has still not been released to the public, but it could be forthcoming in the next few months from the SEC. It is not known whether the settlement will be coming in the form of one check to our program, or an amount for each customer affected. As many as 142,000 accounts could be affected. *Wolff* suggested that it is likely that the program will receive only one check for its losses. *Olle* stated that he has been in contact with the Attorney General's Office and other states that are also facing mutual fund settlement issues. The legal services contract for the program has expired and staff is working with both DOA and the Governor's office to authorize contracting for future legal services to the program.

Finally, he asked for input from the Board on the program's draft Annual Report. *Olle* was also asked about the status of the CD investment option. He stated that it is in the hands of the FDIC and NCUA at this time and that we are still awaiting their approval of our proposal for the portfolio offering. They are aware that the Board is waiting for their decisions on the structure of the investment offering.

VI. D. <u>Program Manager [Wells Fargo] Comments</u> -- Henriksen reported on the year-end marketing plan that was distributed to the Board. As in past years, the focus is on capturing interest based on the tax deduction which is available to Wisconsin taxpayers. Samples of the marketing materials were shown and made available for Board members. She also mentioned the Star award that was presented to the *tomorrow's scholar* program website for best on-line planning center.

VIII. E. <u>Regulation of "529" Programs Update</u> -- *Janosik* reported on recent MSRB guidance and SEC approvals of consumer protection rules for advisor sales of out-of-state 529 plans to their clients. They require suitability analysis be done by the advisor, similar to regulations that cover any mutual fund sales.

He discussed the MSRB advertising guidance under rule G-21 which has been discussed by the national 529 network, CSPN. The network has written a letter to the MSRB in response to its advertising position, explaining why 529 state programs need to have separate consideration from other municipal securities in how the MSRB views their advertising. The MSRB is also looking at its regulations regarding "access equals delivery" standard of offering materials that are used to offer municipal securities to investors. 529 programs differ significantly from other municipal securities, and CSPN is developing a web-based delivery system to allow investors to access state offering materials on-line, and to allow comparisons to be done between different 529 state plan investments.

Finally, *Janosik* mentioned the impact of the recent removal of the sunset of federal tax law treatment of investments in 529 programs. It is now expected that the Treasury Department may issue final section 529 regulations, replacing proposed regulations that have been in place since 1997. This could have a significant effect on how the programs are required to operate, especially in how 529 accounts have been perceived by Treasury to be used as estate planning vehicles.

IX. Announcements -- There were no announcements. The next Board meeting is scheduled for January 29, 2006.

X. Adjournment-- *Voight* moved, and *Wegenke* seconded a motion to adjourn. The motion carried by voice vote and the Board adjourned at approximately 3:18 p.m.