

Tax-Sheltered Annuity Review Committee

Minutes

April 11, 2008

Members Present: Kevin Bahr, Carol Fischer, Kathleen Kelley (Chair), Robert Kunkel, David Porter, Valeriy Sibilkov

Members Absent: Robert Carney, Howard Erlanger, Randall Ryder (Ex-officio), Donna Weber

Staff: Chris Ashley, Sue Chamberlain, Terry Lauber, Rose Stephenson

TSA Vendors: Richard Tesch, Ameriprise/RiverSource; Peter Palmieri, Angela Rinaldo, Dreyfus; Eric Kline, Angela Osborne, Fidelity; Betty Custer, Lynn Gump, Lincoln; Doug DiCocco, TIAA-CREF; James Baumgardner, T. Rowe Price

Guests: Megan Jeffers, UW Service Center

Kate Kelley called the meeting to order at 10:05 a.m.

1. Introductions: The TSA Review Committee, UW System staff, and guests introduced themselves.

2. Approval of Minutes

MOTION: Carol Fischer moved approval of the minutes of the November 2, 2007 TSARC meeting as submitted. David Porter seconded. Motion passed unanimously.

3. Final 403(b) Regulations Summary and Discussion

Materials provided: memo with background on the final 403(b) regulations, including hardship withdrawals, loan monitoring and coordination, contracts (information sharing agreements), and the plan document; March 19, 2008 news release "SPARK Institute Wants Extension on 403(b) Regs Compliance"; spreadsheet reporting the number of loans in 2007, loans outstanding, and number of hardships in 2007 by the investment companies.

Rose Stephenson summarized the final 403(b) regulations. The first provision took effect on September 25, 2007, when 90-24 transfers were no longer allowed. Our plan only allows transfers to approved UW TSA vendors. Rose informed the committee that notification stating our intent to have updated information sharing agreements with all of our companies as of January 1, 2009 was faxed to current investment companies and frozen vendors. Nondiscrimination and universal eligibility are not issues for us; all employees are eligible and we do extensive advertising of our program.

System staff will need to move forward this summer so that appropriate recommendations can be brought to the TSARC at its fall meeting and then sent to the UW System President to approve for implementation January 1, 2009.

a. Hardship withdrawals

In the past participants were able to self-certify that they qualified for a hardship withdrawal. The new regulations do not allow participants to self-certify. Either the plan sponsor or investment company will need to certify that the employee is making the withdrawal due to a hardship that meets the IRS requirements.

Chris Ashley, UW System Legal Counsel, questioned whether we would be able to continue to offer hardship withdrawals. In order to continue, the onus to make this determination would have to be on our companies.

Rose explained that with the State of Wisconsin Deferred Compensation 457 Program, requests for hardship withdrawals are brought before a board that meets four times a year. It goes into closed session

and determines whether each hardship withdrawal should or should not be approved. The TSARC only meets twice a year and Rose expressed doubt that staff or committee members could take on that responsibility. Also, while 401(k) plans have to offer hardship withdrawals, 403(b) plans do not.

(Note: As a follow up to the meeting, Rose conferred with the WDC plan administrator, and learned that participants must complete paperwork and documentation and, with that information, the administrator is able to approve or reject the hardship withdrawals herself. The WDC Board is only involved in the appeals.)

As the spreadsheet shows, only 19 hardships were reported for 2007– the largest number of 11 at TIAA-CREF. Since these were self-certified by the participants, there was doubt whether all 19 would have qualified as true hardships under the IRS definition.

In polling the investment companies, all explained that they would not be in a position to make the determinations and certify the hardship withdrawal requests. The companies would look to the plan sponsors.

There was discussion regarding the feasibility of hiring a third-party administrator. A request for proposal would need to be issued and a contract awarded. The cost would be borne by the plan and passed on to all participants rather than just the very few requesting the hardship withdrawals. Using a third-party administrator would prove to be cost prohibitive.

It was noted that a hardship withdrawal can only be made for an immediate need. For example, a participant could only withdraw money for house payments which are in arrears and not for any following months' payments. The participants calling the investment companies are often frantically in need of funds. A participant could not wait until the committee convenes to make determinations. Also before a hardship withdrawal is approved, a participant must exhaust all other financial means of alleviating the situation including taking a loan from a TSA account.

b. Loans

At the current time Ameriprise/RiverSource, Lincoln, TIAA-CREF and Fidelity offer loans. Dreyfus and T. Rowe Price are working through the details of offering loans. Monies with frozen vendors can be transferred to an approved investment company that offers loans. The participant can then request a loan. Under IRS regulations, the maximum amount a participant may borrow is the lesser of \$50,000 or one-half of the account balance (but at least \$10,000). The total of all loans from UW 403(b) accounts cannot exceed \$50,000. Lincoln and TIAA-CREF are creating aggregator systems. Rose will look at both systems.

Withdrawals are available from the investment companies to participants at age 59 ½ and in the events of death, termination of employment and divorce. WRS does not allow any distributions as long as a participant is employed.

Sue Chamberlain stressed that our plan is subject to IRS audit, and we need to make sure we are in compliance. We would not want to take on a responsibility we would not be comfortable with. Rose stated that staff will be working throughout the summer to rewrite the Plan Document incorporating the final 403(b) regulations. It will be reviewed by Chris Ashley and the investment companies. Also, contracts with the investment companies need to be reviewed.

Considering the timeline before the committee and staff, a motion was made.

MOTION: Carol Fischer moved to eliminate hardship withdrawals as of the date the final 403(b) regulations become effective, the soonest of which is January 1, 2009. Kevin Bahr seconded. Motion passed unanimously.

4. Presentation: Market Overview and Outlook

Eric Kline, Investment Analyst, Fidelity, addressed the TSA Review Committee. He presented a bound report dated April 11, 2008, "Financial Markets Review" with data through December 31, 2007, and a handout "Financial Markets Review as of 03/31/08."

In summarizing the market, Eric observed that one of the biggest things we saw in 2007, which also continues in 2008, is that volatility has returned to the financial markets. There hasn't been this amount of volatility for 6 or 7 years back to the 2001-2002 time period. The silver lining in this volatility is that active management tends to do well versus passive investments. Second, U.S. stocks struggled in the 4th quarter and continued struggling into the first quarter of this year. This is a testament as to why an investor should have a diversified portfolio. Third, foreign stock markets outperformed U.S. equities for a sixth straight year. We have a very weak dollar environment right now. The flip side of this is that exporters are coming to the United States and exporting overseas. Our goods and services look relatively cheap to foreigners. More and more business services coming out of the U.S. are going to be in higher demand around the world. Over time the dollar is going to get stronger. Fourth, treasury bonds posted solid gains and outperformed U.S. stocks. Treasuries have been the best piece of the bond market.

Eric then spoke about recession and inflation in the economy. To qualify as a recession the percent change in the gross domestic product has to be negative for two quarters. That has not happened yet. The federal government looks at the Core Consumer Price Index to determine if there is inflation. Essentially, the CORE CPI is the CPI excluding food and energy prices, which the feds exclude because they feel they have no control over food and energy prices. The Core CPI is more driven by wage inflation, which is something the feds feel they can have an impact on. Eric observed that unfortunately, what we feel is the CPI, which is up almost 4 ½ percent.

Eric then turned to the earnings growth of stocks in the S&P 500 versus performance of those stocks. In the past, the earnings growth rate went down as the economy moved into a recession. Right now the two primary areas driving negative earnings are financial services and consumer discretionary. A recession may be avoided because other areas of the economy are doing quite well overall.

The market returns for the year ending December 31, 2007, show eight of the ten financial sectors as positive; financial and consumer discretionary were negative. For the twelve months April 1, 2007 through March 31, 2008, only four of ten sectors were positive. Looking strictly at the first quarter of 2008, every sector lost money. With the different asset classes (cash, bonds, S&P 500, Russell Mid-Cap, Russell 2000 and MSCI EAFE) for the year April 1, 2007 through March 31, 2008 bonds performed the best. These numbers show why investors should diversify their accounts.

A question arose whether participants reallocate their accounts. Eric stated that when you look across most plans, greater than 80% of participants never make a change in their accounts. Because of this, the lifecycle funds are a good idea.

Eric next reviewed the fixed income market and international equity markets and looked at the efficient frontier as of December 2007 for three different time frames: since 1990, the past five years and the past 12 months. Eric observed that active management has made a comeback in 2007, perhaps since active management can do better in a volatile market environment. 2006 was a low volatile market and 2007 a high volatile market. In comparing the two years, it was easier for active managers to do better in a high volatility year than a low volatility year.

Asset allocation and the benefits of diversification were discussed. The longer the timeframe before a person needs to access the account, the more risk can be taken with the investments. With the Fidelity lifecycle funds, on the date an employee retires there will still be roughly 55% of the monies in equities because the money will be paid out over a 25- or 30-year timeframe. For someone that keeps the money for inheritance, technically it should be allocated for the timeframe of the beneficiaries of those assets, however – keeping in mind that minimum required distributions begin at age 70 ½.

Kate and Rose thanked Eric Kline for his presentation.

The committee broke from 12:25 to 12:50, reconvening with a working lunch.

5. Status of Service-level Criteria Implementation

Rose Stephenson provided a memo dated April 4, 2008 to the committee regarding the status of minimum service-level criteria implementation. She stated we are in good shape with the companies. Areas specifically addressed were:

- a. **T. Rowe Price** –James Baumgardner announced that T. Rowe Price is doing quite well in terms of providing educational events. T. Rowe Price will double if not triple the number of days of counseling this year.
- b. **Dreyfus** – Peter Palmieri reported online enrollment for UW System employees is scheduled to be available September 1, 2008.
- c. **Lincoln** – Betty Custer reported that Lincoln has not seen any change in the number of enrollments since the no-surrender-charge policy for contracts signed on or after 1/01/2008 was adopted. The product is still virtually the same.
- d. **Ameriprise/RiverSource** – Richard Tesch reported there have not been any issues with the implementation of the no-surrender-charge policy on new contracts signed on or after 1/01/2008. Richard worked with John Lynch to communicate the change to the advisors.

6. Report on Process of Monitoring Limits and Requesting Return of Excess

Rose Stephenson presented a report in her memo dated April 4, 2008 to the committee. The investment companies cannot completely do the monitoring since an employee may be contributing to more than one company. The UW TSA program staff takes an active role in monitoring the limits. The number of excess deferrals has been brought down from 20 in 2006 to 5 in 2007, one of which occurred because the participant also contributed to the Thrift Saving Plan with the VA Hospital, and these deferrals must be aggregated with the 403(b) elective deferrals.

7. Update from Insurance Companies on Ratings

Rose Stephenson updated the committee on the insurance company ratings in her memo dated April 4, 2008. An average rating of 3 or greater is required. The company average ratings remain unchanged for TIAA-CREF, Lincoln and Ameriprise/RiverSource at 4, 2.8, and 2.6, respectively. Ameriprise/RiverSource and Lincoln were asked to provide a brief report.

- a. Ameriprise/RiverSource

Richard Tesch reported all of the rating agencies visited Ameriprise/RiverSource in November and December of 2007. Since Ameriprise spun off from American Express, there has been regular contact with the rating agencies. The ratings have stayed the same; agencies did not feel there was enough change within RiverSource's overall situation to warrant any movement in the ratings.

- b. Lincoln

Lynn Gump presented a memo from Lincoln Financial Group/Lincoln National Life Insurance Company dated April 11, 2008 to the committee. A Weiss rating of B- continues to keep Lincoln below the average rating of 3; Weiss continues to report that LNL generates 11% of its business from reinsurance and LNL completely exited the reinsurance business in 2001. The other rating agencies recently reaffirmed their current ratings.

Rose summarized that Ameriprise and Lincoln will continue to be on watch and the plan requirements remain the same.

8. TSA Investment Companies

- a. Ameriprise; status of areas of concern

Rose informed the committee that recently it came to our attention that in 2004 a UW 403(b) participant was allowed to invest in mutual funds with Ameriprise. Ameriprise mutual funds are not an approved investment in the UW 403(b) program; only annuities are allowed for Ameriprise. Richard Tesch, Director, 403(b) Strategy and Solutions, reported the advisor and client were contacted. The situation has been rectified, and no costs were incurred to the client.

Richard stated that because of the regulation changes effective 1/01/2009, Ameriprise/RiverSource is upgrading their technological capabilities. To provide background, Rose pointed out that Ameriprise's recordkeeping system did not have a way to track UW employees separately and account for them. In order to get our annual report information, she has had to provide Ameriprise with a list of social security numbers of participants in our plan. Their new system will be able to identify UW System participants.

Richard announced that Renee Srock has been hired to be the single point of contact for any issues concerning the University of Wisconsin System.

b. TIAA-CREF - Update

Doug DiCocco updated the committee on TIAA-CREF's conversion to a new system. About a year ago he reported they had suspended moving investment plans of institutions TIAA-CREF represents into the new system until infrastructure problems were fixed. In February migration of the remaining institutions to the new system resumed. These are all small-sized institutions. It is hoped that TIAA-CREF's old legacy system can be retired in June. Service level issues and concerns have decreased drastically. Doug reported that TIAA-CREF's service level is now better than their pre-conversion service level. In terms of turnover, greater than 98% of everything received is processed within the first day. The enhancements and fruits of all the pain they went through are now paying off.

The new institutionally based system at TIAA-CREF enables them to create web microsites for their larger institutions. Doug demonstrated the microsite being created for the University of Wisconsin System, which currently is in test format. The microsite includes links to the University of Wisconsin TSA website and pdf documents or fun fact sheets for the TIAA-CREF investments available to UW participants and tools and calculators. At "Enroll Now" UW employees easily find the online enrollment or can print an enrollment form if preferred. There is a direct link with our Salary Reduction Agreement.

Doug distributed the April 3, 2008 press release "TIAA-CREF Names Roger W. Ferguson, Jr. President and Chief Executive Officer, Succeeding Herbert M. Allison, Jr." Herb Allison, who was with TIAA-CREF for over five years during the conversion to the new system, also had the position of Chairman with TIAA-CREF. Ronald L. Thompson is the new Chairman. The Chairman runs the overall direction of the TIAA Board; the CEO and President handles day-to-day operations.

9. 2007 Annual Report and plan information

Rose Stephenson presented the 2007 Tax-Sheltered Annuity 403(b) Program Annual Report. Assets in the plan have grown to over \$1.6 billion, up from \$1.51 billion in 2006. 2007 contributions were over \$77.2 million, up from \$74.6 in 2006. Continuing a pattern from past years, contributions to mutual funds, TIAA-CREF and WRS have gone up and those to insurance companies have gone down slightly. Approximately 20% of the participants make up 52% of the contributions. In 2007, 920 participants contributed \$19,000 or more. Overall slightly more than 34% of all permanent employees participate in the TSA Program. The percentage of employees in the program has decreased since 2002. Committee members pointed out that with dwindling budgets, when a faculty member retires part-time instructors are often hired rather than continuing with a full-time position. These part-time employees may have another position elsewhere and tend not to enroll in the TSA Program. Looking at the allocation of contributions, there has been an ongoing trend away from large-cap funds. We see increased contributions to mid-cap funds and a decrease to small-

caps. There are more contributions to real estate than to all of the small caps combined. In looking at past years, the TIAA Traditional Annuity has consistently been the first or second most-used fund.

10. Review of Educational Initiatives

Terry Lauber reported on the 2007 educational initiatives. The investment companies self-reported their individual counseling provided during 2007 with TIAA-CREF counseling 755 employees; Fidelity, 458; Lincoln, 662; Ameriprise, 535; Dreyfus 166 and T. Rowe Price, 69. The companies attend the fall Benefits Fairs which enable them to reach out to a large number of people at one time. Employees receive messages on their earnings statements about the TSA Program. The documents "2007 Campus Visits by UW-System Administration Staff" and "2008 Campus Visits by UW-System Administration Staff," along with a printout of the UW TSA website with the "Individual TSA Counseling Sessions and Group Seminars Available" by the investments companies, were provided to the committee. Committee members David Porter and Kevin Bahr made presentations to their campus employees in conjunction with Terry's presentations.

11. Communications Plan – Report on initiatives

Rose Stephenson reported on the initiatives of the communications plan in her April 4 memo to the committee. Committee members received a sample copy of a letter to new employees and its enclosures, a spreadsheet of the number of employees by institution that received the letter, and a list of 2008 payrolls which have earnings statement messages about the TSA Program.

Since a good percentage of employees enrolled in the TSA Program after receiving a mailing in 2007, a mailing was again sent to new employees this year. This year 3,602 employees were contacted – 972 packets were sent out by UW system staff, the remaining 2,630 employees received e-mail messages. Rose will report to the committee on the results of the 2008 mailing at its fall meeting. TSA materials were updated and are on our website. UW System staff worked with investment companies and conducted presentations to provide investment education to campus employees. The spring TSA *Investor* newsletter will be published for employees with plan updates.

12. Reappointment of Members; Resolution of Commendation

Rose informed the committee that the current terms for Howard Erlanger, Kate Kelley and Donna Weber have ended. These members will be contacted regarding their reappointment.

Robert Carney is retiring and therefore resigning from the TSA Review Committee. Kate Kelley read the "Resolution of Commendation" for Robert Carney expressing the committee's thanks and appreciation. Due to illness he was unable to attend this meeting.

MOTION: Carol Fischer moved to adopt the "Resolution of Commendation" for Robert Carney. Robert Kunkel seconded. Motion passed unanimously.

13. Next Meeting

The fall TSA Review Committee meeting will be November 14, 2008.

14. Motion to Adjourn

MOTION: David Porter moved that the meeting be adjourned. Kevin Bahr seconded the motion. Motion passed unanimously. The meeting was adjourned at 2:15 pm.