

Tax-Sheltered Annuity Review Committee

Minutes

April 24, 2009

- Members Present:** Kevin Bahr, Howard Erlanger, Carol Fischer, Kathleen Kelley (Chair), Robert Kunkel, David Porter, Valeriy Sibilkov, Donna Weber, Robert Wolf
- Members Absent:** Wayne Argo (Ex-officio)
- Staff:** Chris Ashley, Sue Chamberlain, Terry Lauber, Rose Stephenson
- TSA Vendors:** Laura Gagnon, John Lynch, Richard Tesch, Ameriprise/RiverSource; Paul Mazziotti, Angela Rinaldo, Dreyfus; David Burke, Angela Osborne, Fidelity; Kelly Clevenger, Betty Custer, Lynn Gump, Lincoln; Mike Mitchell, TIAA-CREF; Danielle Rogers, T. Rowe Price
- Guests:** Lauren Meyer, 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: Robert Kunkel moved to approve the minutes of the November 14, 2008 TSARC meeting as submitted. Carol Fischer seconded. Motion passed unanimously.

3. Plan Criteria Revisions

Rose Stephenson reviewed the *TSA Criteria* and has proposed changes to bring the document up to date. Items deleted as they no longer apply to our Plan are: (1) the definition of the Maximum Exclusion Allowance, (2) section III.B. referencing the UW TSA Review Committee determining the fixed annuity minimum guaranteed interest rate, (3) section IV.B.1. referencing general investment account charges, and (4) Appendix A, item D., Exception to Terminated Vendor Procedures. These are housekeeping and non-substantive changes that do not affect the structure of the UW TSA Plan and therefore do not require the approval of the UW System President.

MOTION: Howard Erlanger moved to adopt the proposed changes to the *TSA Criteria*. Donna Weber seconded. Motion passed unanimously.

At its November 14, 2008 meeting, the TSARC voted to no longer use Weiss Ratings to evaluate the financial stability of insurance companies. The Street.com bought out Weiss and Weiss Ratings, as such, were no longer available. TheStreet.com was not providing new rating evaluations, and therefore no TheStreet.com ratings were available for RiverSource Insurance Company.

Since Insurance Vendor Rating Requirements are part of the UW *TSA Criteria*, changing the ratings agencies that are used to evaluate the financial stability of UW TSA insurance companies means that we must modify the *Criteria* substantively, which requires the approval of the UW System President.

Staff recommended forming a subcommittee to review our method for evaluating the financial stability of UW TSA insurance companies, draft language for the *TSA Criteria*, and report back to the TSARC at its fall meeting. The TSARC can then make changes in the *Criteria* at that meeting for the President's approval. Kevin Bahr, Robert Wolf, Carol Fischer and Robert Kunkel volunteered to serve on the subcommittee.

4. Report on Insurance Companies' Ratings and Discussion

- a. Summary of ratings criteria and of discussion with UW-Madison Professor of Risk Management and Insurance, Dan Anderson

Rose reported on the insurance companies' ratings. We require an average rating of 3 or greater from the four rating services, Best, Fitch, Moody's, and S&P, calculated by adding indicated point values from the *Criteria* and dividing the sum by the number of ratings included.

TIAA-CREF's rating remains a 4. They have the highest ratings from every rating agency.

Lincoln received downgrades from Fitch, Moody's and S&P in March and on April 16 subsequent downgrades from Fitch and Moody's.

RiverSource has been on watch since April 2006, when the current method of evaluating the financial stability of our TSA insurance companies was approved. Lincoln also had been on watch from April 2006 until November 2008. After the TSARC voted to remove Weiss ratings from those used to evaluate our TSA insurance companies at the last TSARC meeting, Lincoln had a 3 average and therefore was no longer on watch. Lincoln now has a 1.25 average. RiverSource remains at a 2.5 average.

Rose reported on her conversation with Dr. Dan Anderson, Professor of Risk Management and Insurance at UW-Madison, about Lincoln's downgrades. Dr. Anderson is most familiar with the A. M. Best ratings and was encouraged that Lincoln's Best rating is an A+; however, he would be concerned if the Best rating dropped to an A. He noted that Lincoln's stock had gone down dramatically this past year but went up recently, perhaps because there was mention in the past few days that insurance companies may be receiving some of the Troubled Asset Relief Program (TARP) money. Insurance companies with annuity products may get in trouble because they must meet their obligations for minimum guarantees on their fixed investment products and on death benefits on the variable products. Dr. Anderson mentioned that there is more of a safety net in Wisconsin than in other states, should something go wrong, since our State Guaranty Association provides \$300,000 worth of coverage for annuity products, whereas other states provide only \$100,000 coverage on cash values for life insurance or annuity products.

- b. Lincoln – Report on recent downgrades

Betty Custer, Client Relationship Manager, introduced Kelly Clevenger, Senior Vice President of Defined Contribution Products, who has implemented changes with the UW TSA 403(b) Plan that Lincoln has been required to make over the years. Kelly commented that what is happening to Lincoln is happening to insurance companies in general. What we are seeing with the rating agencies is not necessarily due to things that have already happened; it is a commentary on their concerns on what could happen because of the economy. The rating agencies are worried about earnings power and concerned about the investments. Some of the future earnings would need to be from increases in the market. Insurance companies have to have capital or reserves. Lincoln recently reduced its dividend to raise the capital to reduce debt.

Mr. Clevenger went on to say that Lincoln is taking steps to prudently manage holding company liquidity in this environment. It has repaid a \$500 million debt maturity on schedule and in full, and also has plans to reduce its outstanding commercial paper by \$200 million. The source of funds for the debt repayment includes a \$400 million ordinary cash dividend from Lincoln National Life Insurance Company and a \$300 million dividend from the company's principal reinsurance subsidiary.

Lincoln does not know if it will accept TARP money; however, it has taken the necessary steps to be eligible. Lincoln may prefer not to use TARP money because it reduces a company's management flexibility, but Kelly commented that he could not speak for Lincoln management. Lincoln took steps to increase its capital structure. Kelly noted that it is unknown what will happen in the future with ratings; however, Lincoln's ratings are still good.

c. RiverSource – Update

Richard Tesch, Director, 403(b) Strategy and Solutions, introduced Laura Gagnon, Vice President, Investor Relations, who manages their relationships with the major ratings agencies. Laura pointed out that Ameriprise/RiverSource has a strong financial foundation. All four ratings agencies affirmed RiverSource's ratings in the past three months, while most of its insurance peers have been downgraded by at least one agency. The rating agencies have the industry on negative outlook, and Ameriprise/RiverSource's rating trends were on a positive outlook until the market turmoil. Ms. Gagnon stated that because of its comprehensive enterprise risk management approach, Ameriprise/RiverSource has a stable outlook. With \$5.8 billion cash and cash equivalents on the balance sheets the first quarter of 2009, RiverSource has \$4 billion of what it considers "free cash." The company believes in a conservative approach given the uncertainty of the market. No debt matures until November 2010, and they are very well positioned with liquidity. Excess capital has increased to \$1plus billion between the end of the year and first quarter. The debt ratios are fairly conservative.

Laura stated that Ameriprise Financial's integrated business model, strong balance sheet, and ample liquidity have allowed them to support their clients. Because of their diversified businesses, they maintain substantially more assets and capital than stand-alone brokerage or asset management companies. As a result, Ameriprise/RiverSource chose to (1) provide up to \$700 million in liquidity to help their retail distribution clients overcome the impact of The Reserve Fund closure and (2) support their investment clients' holdings in RiverSource Money Funds when Lehman declared bankruptcy. Laura further pointed out that separate account assets and liabilities are held for the exclusive benefit of variable annuity contract holders.

Rose mentioned that there have been a number of service issues with Ameriprise/RiverSource over the years. For example, there have been transfers to companies outside of our plan and agents who are not familiar with our program. Richard Tesch responded that they try to fix situations as quickly as they can and value their relationship with the University of Wisconsin System.

d. TSARC action regarding insurance companies' ratings

Rose went through the potential actions the committee could take as listed in the *TSA Criteria*. The president must approve actions taken by the committee to terminate or restrict a vendor.

Rose reiterated that Lincoln has received downgrades from three of the four rating agencies with additional downgrades from two agencies, and its financial stability ratings no longer meet the requirements in the *TSA Criteria*. It is troubling that written background information regarding these downgrades was not available sooner.

MOTION: Carol Fischer moved to: (1) Temporarily suspend Lincoln's ability to enter new TSA contracts, with the potential for reinstatement. (2) Notify affected participants of Lincoln's failure to meet criteria requirements. Lincoln will be required to pay the cost of printing and mailing the notification. (3) Require that clients having fixed annuity investments be permitted to move those investments to a different company or to a variable sub-account with Lincoln without surrender charges. This condition will remain in effect until the company's ratings improve. Kevin Bahr seconded. Motion passed unanimously.

Rose reiterated RiverSource has failed to meet the minimum financial stability ratings for insurance companies since 2006 and remains on watch. There have been repeated incidents of poor customer service, agents have been difficult to deal with, and interactions with RiverSource personnel have caused friction with benefits staff at our campuses.

MOTION: David Porter moved to: (1) Temporarily suspend RiverSource's ability to enter new TSA contracts, with the potential for reinstatement. (2) Notify affected participants of RiverSource's failure to meet criteria requirements. RiverSource will be required to pay the cost of printing and mailing the notification. (3) Require that clients having fixed annuity investments be permitted to move those investments to a different company or to a variable sub-account with RiverSource without surrender

charges. This condition will remain in effect until the company's ratings improve. Donna Weber seconded. Members approved the motion with two opposed. Motion passed.

The committee broke from 12:45 to 1:00 reconvening with a working lunch.

5. Report on Effect of Final 403(b) Regulations

a. Loan administration

Under the new regulations, loans must be closely monitored to assure that no participant exceeds the limit of \$50,000 from all sources. Loans must be aggregated across investment providers and loan repayments must be monitored and enforced. In the UW TSA Plan, only one outstanding loan is permitted at any time, even if a participant has accounts with more than one investment company. All companies in our TSA Plan except Dreyfus can provide loans to participants. To help inform participants of our loan provisions TIAA-CREF has agreed to send a letter to all UW TIAA-CREF participants – current and former contributors. We appreciate TIAA-CREF's willingness to send this letter. Since January 1, 2009 staff has approved 23 loans.

b. Process of verifying termination dates

Rose reported the process of verifying termination dates and/or approving distributions has proven to be very burdensome and labor intensive. Our companies have been working with us to streamline this process. The campuses received a "cheat sheet" describing the procedure for each company.

c. Actions other plans have taken

State agencies with 403(b) plans contacted Rose regarding the effect of the IRS Final 403(b) Regulations. The Departments of Public Instruction, Corrections and Administration and the Historical Society terminated their 403(b) plans. The UW Hospital, which had kept their 403(b) plan much as it was when the hospital was part of the University, decided to make changes for easier administration; they do not permit hardship withdrawals, loans or the 15-year rule service catch-up.

The committee complimented Rose and staff. The fact that the agencies came to us for help speaks of the quality of the work.

6. Presentation: Market Overview and Outlook, David Burke, Investment Consultant, Fidelity

Angela Osborne, Relationship Manager, introduced David Burke, Investment Consultant. He presented a Quarter One 2009 Market Update, along with some market history, to the committee.

To summarize the quarter one 2009 market:

- (1) After a calamitous 2008, the global economy and credit markets were still rocky in quarter one.
- (2) U.S. stocks sank to new lows in the first quarter; however, some of those losses have been recovered and we are in a bull market right now.
- (3) Foreign markets also declined, though there were mixed results by country.
- (4) Fixed-income markets remain volatile, but we have seen some positive signs as a result.

Mr. David Burke reviewed the economy in general. Looking over history, the personal savings rate increased as wealth plummeted. At the current time things are bad, but not as bad as they were. Unemployment seems to be stabilizing a bit. Many economists predict it will get to be 10% before it bottoms, and currently we are around 8.5%. Housing is one of the primary factors that led us into the current economy. The good news is we have gone from 11 months supply in the market down to 9 months. The Institute for Supply Management Manufacturing New Orders Index looks like it has bottomed. Over history when the ISM has bottomed, this has led to a recovery. There is an uptick at the current time.

David next spoke of the government stimulus and implications. When we look at some of the major purchases/major costs that we have had in the past, whether the Korean War or the Louisiana Purchase, they

are dwarfed by what we have seen just in the first quarter alone. Back in the Great Depression, the government really did not do much. They could not really expand the monetary base because we were on the gold standard then. When addressing whether the stimulus will work, factors that need to be looked at are the complexity of the implementation, the uncertainty about bank policy, the uncertainty about execution/effectiveness, the fiscal impact and the inflationary impact long term. The market is still relatively volatile because of the unknowns. We have the largest deficit since World War II. There is the concern of inflation and the weakening U.S. dollar, but every country around the world is in the same situation we are.

Looking at U.S. equity markets, the story was not good overall. In quarter one 2009, looking at U.S. equity performance, NASDAQ fared the best. Technology is considered to be a fairly cyclical industry. Financials performed the worst in the first quarter. Looking at the number of 12-month returns above the S&P 500, the consumer discretionary sector has been above that 8 out of 8 times since 1960 when we have had "bull markets." It will be interesting to see if history repeats itself. The fourth quarter 2008 had the first ever earnings loss for the S&P 500 since records began back in 1935. The bear market has been the worst since the Great Depression. The biggest returns occurred early in the bull markets.

Touching on the international equity markets, in the first quarter emerging markets had a snapback. The U.S. dollar strengthened during quarter one. Foreign stock valuations remained low in quarter one. David reviewed the fixed income markets and long-term investing concepts.

The committee thanked David for his presentation.

7. TSA Investment Companies

- a. T. Rowe Price – continued negotiation on new record keeping and custodial agreements
Danielle Rogers reported they just received the last revisions from UW System, and they agreed with most of them. If there is anything the UW wants to make sure is in the agreement, she will go back to management and then approach their legal department. The agreement is close to being completed.
- b. Dreyfus – custodial and services agreement
The Dreyfus agreement is in the process of being negotiated.
- c. TIAA-CREF – funds merging
Mike Mitchell reported TIAA-CREF is merging some of their index funds that have overlapping investment objectives and strategies. The merger is expected to occur on June 12, 2009. The TIAA-CREF Small-Cap Growth Index Fund and TIAA-CREF Small-Cap Value Index Fund will merge into the TIAA-CREF Small-Cap Blend Index Fund. The TIAA-CREF Mid-Cap Growth Index Fund, TIAA-CREF Mid-Cap Value Index Fund and TIAA-CREF Mid-Cap Blend Index Fund will merge into the TIAA-CREF Equity Index Fund.

8. 2008 Annual Report and Plan Information

Rose presented the 2008 Annual Report. Contributions as reported from payroll records totaled \$77,360,699.60, which is slightly more than in 2007. Assets declined by more than 26% to \$1.18 billion from \$1.6 billion in 2007. Contributions to mutual fund companies accounted for approximately 44%; TIAA-CREF, 41%; insurance companies, 12% and WRS, 2%. The average TSA contribution was \$6,779; the median contribution \$4,200. Of our participants, 13.6% contributed \$1,000 or less; 55% contributed \$5,000 or less. Fifty-three percent of contributions came from 20.5% of contributors deferring over \$13,000. In 2008, 922 participants contributed \$19,000 or more – 291 contributed over \$20,500 (using service catch-up). TSA participants on average have a higher salary and are somewhat older than the average employee is when looking at employee type. In reviewing the history of asset allocation in our plan,

exposure to equities has been decreasing. Over the last several years there has been a steady decrease to large-cap funds; large-cap assets now make up 29.27% of plan assets compared to 40.89% in 2004.

9. Review of Educational Initiatives

Terry Lauber presented a review of the educational initiatives. In 2008, the investment companies provided over 150 days of counseling reaching almost 2,500 employees. All companies attended at least five benefits fairs; most companies attended more. David Porter, Kevin Bahr and Bob Kunkel made presentations at their campuses in 2008 as well as presentations by Rose and Terry. Carol Fischer made a presentation in April 2009. TSA companies are busy with counseling sessions at campuses this spring. Earnings statement messages provide a reminder to employees about the TSA Plan.

10. Next Meeting

The fall TSA Review Committee meeting will be September 18, 2009.

11. Motion to Adjourn

MOTION: Carol Fischer moved that the meeting adjourn. Robert Kunkel seconded. Motion passed unanimously. The meeting adjourned at 2:25 p.m.