

OREGON UNIVERSITY SYSTEM
RETIREMENT PLAN REDESIGN
FACULTY ADVISORY COMMITTEE

JANUARY 20, 2007
SATURDAY
9: 30 A. M.

BOARD ROOM
OIT METRO/CLACKAMAS COMMUNITY COLLEGE

Committee: Jeff Vermeer (EOU); Richard Bailey (OIT); Alan Acock (OSU); Starr McMullen (OSU); John Settle (PSU); Kip Sigetich (SOU); Larry Dann (UO); Joe Stone (UO); Tom Burrell (WOU). Absent: Ray Johnson (PSU)

OUS: Jay Kenton, Denise Yunker, Mike Green, Howard Biggs (Arnerich Massena)

Guests: Mina Carson (IFS); Cathy LaTourette (PSU)

WELCOME

Vice Chancellor Jay Kenton welcomed the Committee, and expressed he'd like the committee's work be through a consensus model with representatives as a liaison between campuses, using a process where all have a say and, when completed, everybody can live with the result.

Kenton noted OUS started work to revise the plans a year and a half ago, thinking about a fairly different model for both ORP and TDI funds, and recently recognized a need to reach out to a broader community. To date, under the proposed concept, OUS let an RFP and has vendor responses, but hasn't selected a recordkeeper. The Oregon State Board of Higher Education has taken some action to support the redesign, which can be revisited, including adoption of an Investment Policy for the Tax-Deferred Investment 403(b) plan. Today's meeting is to talk about the current proposal, which is a state of the art plan design. Because OUS will have to revise its management of the Tax-Deferred Investment 403(b) program (TDI) plan under new, proposed federal regulations, inaction will not be an option.

Consolidating the ORP and TDI investments and recordkeeping would bring greater plan assets to the negotiating table in securing improved plan services and favorable rate structures for participants of both plans.

The new plan design focuses on asset-class based investing, replacing individual contracts that focus on individual companies and fund families.

Conversion to a redesigned TDI plan should be complete by January, 2008, in anticipation of the proposed 403(b) Treasury Regulations, and decisions about ORP recordkeeping and investment menus are required spring term to move forward with the time-sensitive elements of the plan redesign.

Kenton asked the committee to review the proposed plan design as a "straw man" model to introduce the factors that affect OUS' plan redesign project. He noted that OUS will reconsider the design and invited the committee to propose modifications and alternatives.

ADVISORY COMMITTEE CHARGE

The Advisory Committee recommended a revision to the Committee's charge, to note that participant education and reducing barriers to participation in the TDI plan is important in encouraging its use for voluntary savings. The

goal is revised to state, "The Committee will work with OUS staff and advisors to achieve the following goals:

- Compliance with proposed treasury regulations for the 403(b) program
- Improved access to plan information, education and services for OUS participants
- Availability of a selection of high-quality, low-cost investments
- Encourage employees to be actively engaged in their retirement planning and to set up plans that make that easy for everyone

EXCHANGE OF INFORMATION

The committee noted that they were nominated to serve as liaisons for faculty, and that non-faculty employees are also interested in providing input and being kept abreast of the information about the proposed plan redesign. To effectively work with constituents on each campus, mail lists will be established, available from a central website, to allow readers to directly communicate with their campus committee members and benefits staff. Campus staff will provide trend analyses, and committee members will be able to review all e-mails from their campuses to raise issues when the system-wide committee meets.

Equally important, the committee noted, is being able to see issues, questions, phrasing, and perspectives that will arise from a diverse participant population of interested plan participants.

The committee recognized that it will be important to publish key information so plan participants are able to resolve many of their own questions. In addition, participants will be able to raise "on point" issues for the committee once there is broad understanding of any redesign options the committee is considering. To effect this, web pages for the retirement plan redesign will be populated with materials and information coming from this committee's work.

Committee members will interact with their respective campus communities to provide information and to receive feedback, and will coordinate within the committee to formulate advice to OUS that is applicable to the systemwide retirement plans.

Questions and Issues Addressed

1. One goal of the retirement plan redesign, rather than to increase voluntary participation in the TDI plan, should be to seek ways to educate employees on the reasons and ways to use the voluntary retirement savings TDI plan, and to reduce barriers to participation in such a way more employees are encouraged to participate.
2. To reach all employees -- faculty, administrators, and classified staff -- a communications system should be established for intra-campus communications and information that would be forwarded to the advisory committee and OUS to have a good grasp of campus and system-wide questions. An enhanced website and mail list system was proposed for rapid development by OUS.
3. The committee noted that participants will not support any changes that will add expenses they would have to bear.
4. The committee requested an estimate of expenses participants pay now and would pay under the proposal to use a consolidated recordkeeper and investment menu. The committee explored the inter-related cost components - recordkeeping and investment fund management -- of the proposed structure.
5. The committee received an in-depth review of the proposed concept for the plan, including confirmation that no change would be required in any regulations or state laws to adopt the modified structure.

6. The committee began discussion of the rationale for combining the investment menus for the TDI and the ORP.
7. Discussion will be extended through subsequent meetings on the types of investment products -- mutual funds and annuities -- offered through the plans.
8. The responsibility of the Investment Committee, Investment Consultant, and plan sponsor (OUS) was raised vis-à-vis fiduciary roles in plans with participant-directed investments. In particular, the committee will review the TDI Investment Policy that guides selection of investments that will be available through the TDI plan.
9. The committee recommended more discussion about the investment menu -- the asset classes in the core menu of the proposed design, especially -- and how that menu would be communicated to participants.
10. Some participants have expressed concern about changing the relationships they currently have with vendors' representatives, and how investment education and counseling would be provided under the proposed model.
11. The committee requested information on what a new "front end" recordkeeping system would look like to participants.
12. Specific topics noted for further discussion are included in the last section of the minutes.

PLAN DESIGN BACKGROUND

Plan design fundamentals were outlined by consultant Howard Biggs, with committee discussion and participation in clarifying points throughout the background presentation.

Key points of the presentation and committee discussion included:

- Project Overview: Current plan design and goals of redesign
- Plan Design Components: Regulatory Environment, Recordkeeping/Operations, and Plan Investments
- Work Performed to Date

PROJECT OVERVIEW

The plan design project has been to evaluate the current programs for the TDI and ORP, for their operating structures and costs to identify opportunities to improve participant service, enhance the investment opportunities for the participants, and reduce participants' costs.

The cost of these plans is currently borne by participants through their selected investments. Participants who utilize the programs invest in various investment products, with associated investment expenses that pay for the services provided to the participant.

One goal of the plan redesign is to make the retirement program more efficient to reduce investment drag, or cost, that takes away from long term growth of the participants' accounts.

Another major goal is to position the programs to conform to the evolving regulatory requirements. Proposed 403(B) Regulations are putting more responsibility on employers to oversee employees' voluntary retirement savings plans.

Finally, OUS has 17 TDI vendors. Participants regularly face the selection task of making decisions about which vendor to select among the list of vendors. Then, they have to assess not only the vendor -- what education, information they are going to receive, who is selling to them, and how comfortable they are with that company -- then they have to make investment decisions about the investments the vendor offers. Participants experience information and decision overload, making it more difficult than need be to take advantage of the voluntary TDI retirement savings program.

REGULATORY ENVIRONMENT

Under the regulatory backdrop to the OUS retirement plans, the Internal Revenue Service code establishes tax elements that give TDI and ORP investments tax-deferred status, as long as the plans meet certain IRS requirements.

Evolution in federal regulations, particularly for the 403(b) TDI plan, is bringing more oversight responsibility to the employer, similar to the type of regulation has existed for many years in plans available in the private sector.

In the 403(b), because of the way the Internal Revenue code was originally set up, it is limited to just two types of investments, mutual funds and annuities. In OUS, that same structure applies to the ORP, mandated by state law. The proposed plan structure does not require any change in the state rules for either of the OUS plans.

RECORDKEEPING

Recordkeeping is an accounting function performed by a retirement plan provider that, regardless of whether there are 10, 50, 100, 100,000, or 200,000 employees participating in a program, requires a certain amount of infrastructure -- software, systems, etc. Recordkeeping service providers maintain individual account records, produce statements, process participants' transactions, etc. With the 17-vendor TDI program, each with its own recordkeeper, OUS replicates infrastructure and its associated costs 17 times over.

When plans can eliminate the redundancy of the accounting function plans can reduce costs. This is important because there is a direct or correlated relationship between the recordkeeping cost, i.e., the overhead cost of accounting, to the investment expense the participant pays to cover that cost.

Investment products bear an expense ratio, or total investment cost, for any investment product. From within that investment expense, a portion goes to pay recordkeeping.

The plan redesign is seeking to eliminate recordkeeping redundancy with its overhead burden, maintain and preserve investment flexibility, and reduce investment costs paid by participants.

Investment cost burdens vary by mutual fund and by annuity, but will not be increased by consolidating recordkeeping services through one vendor. Biggs noted that with respect to any given fund, the pricing available from the fund company itself is subject to the company's contractual arrangements. OUS can't say with respect to any vendor, without going through a finalized contract, whether a particular vendor would create or offer a lower cost/expense ratio on their product. However, when the aggregate recordkeeping cost goes down, the aggregate investment cost can go down.

An organization that serves as a plan sponsor serves a wide variety of participants who are doing different things with their investment portfolios. OUS' objective as the plan sponsor is to meet the needs of a wide group of people. Under the proposed design, many participants would see cost reductions. People with large account balances, who have selected vendors with good price discounts on mutual fund products, would be essentially where they were in terms of investment cost, possibly with some modest savings because of some power of aggregation that takes place.

PLAN INVESTMENTS

The smaller part of total participant cost is the recordkeeping cost. The larger part is investment cost. Depending on the investments a participant chooses, that participant may have greater or lesser costs of investing. Various investments and types of investment products bear a range of investment costs.

In the two OUS plans, investments are through mutual funds and annuities. Whether the investment product is an annuity or a mutual fund, they are both accumulation vehicles.

In the ORP, inclusion of annuities is required by state law. In the 403(b) redesign, OUS has been proceeding under a kind of ORP-mirrored arrangement to include annuities as well as mutual funds, but in the 403(b) there could be no annuity investment products. However, the committee recognizes current participants rely on their current sales representatives offering annuity investments.

When the new 403(b) regulations come into play, there is increased plan sponsor responsibility for the array of investments in the TDI plan. Green noted the Investment Committee is charged to select low cost, high quality funds for the TDI platform.

Since not all vendors offer annuities, under the proposed open architecture plan design it will be necessary to select a vendor that has the recordkeeping ability to handle both types of investments -- mutual funds and annuities--including annuities that are not the recordkeeper's proprietary products.

Currently, annuities are the predominant type of investments in the TDI plan, due to a number of factors, including the history of how 403(b) plans developed and direct marketing by companies that are authorized vendors in the current TDI program.

INVESTMENT MENU CONSTRUCTION

Investment products are generally identified by asset class -- fixed income, domestic and international equity -- and investment style -- growth, value, and/or core. Other asset classes are considered in other menus -- generally speaking, balanced fund, age-based, target retirement year, or risk-based type products and, to some degree, sector-based investing either for specific indexes or specific sectors. Real estate can be popular, etc.

The second way the menus can be set up is by using a selection of actively managed investment products where an investment manager or firm oversees the portfolio, and passively managed index-based products.

In constructing a plan menu, the plan is trying to meet diverse participant needs, and to give opportunity for people to span a risk-and-reward spectrum. The proposed investment structure -- asset allocation products, a core menu of investments, and self-directed options -- correlates to participants with different levels of interest or sophistication about investment.

For example, there will be a group of participants who have very little interest in making investment decisions but might have a sense for their tolerance for investment risk. Often, plan sponsors, the recordkeeping community, or the investment community create arrays of choice that are risk-based or age-based asset allocation pools. It makes it easy for the participant to make a simple investment choice decision without having to spend a lot of time researching or monitoring the investment.

The second tier of investor may use a core investment menu which offers investments in the major asset classes with good quality, low cost passively managed index products and good quality, lower cost or institutional -cost actively managed products.

For a participant who is very involved and savvy about investing - has the time, resources, capability, inclination, etc. -- and may want to

invest in a wider array of choices than is on the core menu, the proposed model offers a self-directed option which, in this plan design, is a mutual fund window with a wide array of thousands of funds to choose from.

If the proposed design is implemented, the Investment Committee uses an Investment Policy that guides it in its decision-making to select different funds for each of the asset categories. It doesn't matter which company offers the investment products; it's whether or not the investments are benchmarking well against their respective indexes over time, and what their costs are. After a market cycle, a fund that doesn't meet the Investment Policy benchmarks may be watch listed or replaced. In the proposed plan design, a participant selects one or more asset classes based on what meets her/his investment strategy and goals rather than selecting a specific investment company or fund. In each asset class, the menu will show each fund name and ticker symbol, so participants can do their own fund research, as desired.

If an investment fund is replaced by the Investment Committee, the plan rolls money from the prior, underperforming fund to the newly selected investment fund that replaces it in the same, underlying asset class. Participants may change their selections at any time, but the plan will take care of moving account assets held in trust to a replacement fund selected by the Investment Committee.

For participants who select actively managed investments on the core menu, the plan sponsor monitors funds to make sure they are staying within the zone of performance, style and cost where they started. For example, if the Investment Committee slotted a small cap manager onto the investment menu, and that manager let the fund's asset pool grow so large that it migrated out of the small cap category, then the plan would have to decide what to do about that as an Investment Committee decision.

The Advisory Committee remarked it is important to communicate there's no way costs go up for any individual in any individual account, and agreed the plan architecture isn't going to increase the costs to participants. Biggs commented that the investment choices a participant makes, however, could have different effects. If a participant stays in the exact same fund costs won't go up, no matter which fund it is. Costs may, in fact, go down.

But a participant may not be able to stay in the same fund if the plan doesn't offer it. If the fund, for whatever reason, is not on the menu and it's not in the window, then the participant will have to make another choice that could have higher fees. Nevertheless, the odds are good that inside the mutual fund window or with the main menu OUS could get many of the same funds. OUS can't guarantee every single fund, but expects to be able to get most of those currently on the plans' investment menus.

WORK PERFORMED TO DATE

Between May and November 2006, OUS' consultant evaluated the plans' structures; came up with a proposed structure for the program; and developed a preliminary investment menu approach, consisting of asset allocation, core menu, and a self-directed mutual fund window to address the needs of less sophisticated, more sophisticated, and then highly sophisticated investors.

OUS adopted an Investment Policy for the proposed TDI plan investments in September 2006. Consultants developed a preliminary investment menu and the Investment Committee tentatively identified a preliminary selection of mutual funds. Finally, there has been a recordkeeper/custodial services provider search -- those are intertwined services -- for which OUS is going through a process of identifying top candidates.

PLAN TRANSITION

Whichever plan design is adopted, there will be implementation steps. On the 403(b), "old" TDI accounts balances would not transfer to the new plan, unless requested by the participant. Participants could leave their current accounts with their current TDI vendors. New contributions, however, will flow to the new investments via the new recordkeeper. Under the ORP, it would be a plan level change, with "old" money moving to the new plan.

Federal rules are changing in terms of when participants can transfer funds among TDI accounts. It will be important for OUS to help participants understand what rules will apply to their old accounts as the Treasury regulations are finalized.

NEXT STEPS

Topics Identified for Future Discussion:

1. Inclusion of mutual funds and annuities on the TDI menu.
2. More level of detail about progress so far, including the Investment Policy Statement.
3. Thinking longer term, a big issue to address is the extent to which TDI and ORP are under the same umbrella or converge to look more like one another. It's useful to talk about the TDI as an example; then examine where ORP fits relative to that.
4. A key issue is in TDI you don't necessarily have to roll the funds over. In ORP you would have to roll them over.
5. Fees.
6. Discuss the parameters the Investment Committee uses to identify high-quality investments (in preliminary discussions, called "best-in-class" but revised to connote other quality measures besides top percentile earnings).
7. Asset classes that are represented in the core list, and what that final menu looks like.
8. The TDI plan document that outlines administration rules.
9. If there are default investment provisions, how will those work and how will they be used?
10. Asset-allocation type investment options for investors who want appropriate investments for their retirement needs, but do not want to actively manage their own portfolios.
11. At the point of plan conversion, should people have to go through an open enrollment process, or is a default transfer that allows a participant's funds to stay in an appropriate asset allocation fund until directed a better option?
12. The key point is to determine if the proposed structure should be pursued, with or without revisions, or if there are other structures that will achieve the goals outlined in the Advisory Committee's charge.

Next meeting: February 3, 2007