

MINUTES
SCHOLARSHARE INVESTMENT BOARD

October 14, 2004, 9:00 a.m.
Teleconference

Chair Ted Eliopoulos called the meeting to order at 9:11 a.m.

Present: Ted Eliopoulos for Phil Angelides, State Treasurer
Tom Dithridge for Donna Arduin, Department of Finance
Cathleen Cox for Richard Riordan, Office of the Secretary for Education
Allison Jones
Sabrina Kay (via phone)
Maria Elena Serna

Staff: Carrie Douglas Fong, Executive Director, ScholarShare Investment Board (SIB)
Marian Cohen, Manager, SIB
Dennis Siebert, SIB
Chris Lynch, Regional Director, TIAA-CREF Tuition Financing, Inc. (TFI)
Carla Raffin, California Program Manager, TFI
Kevin Seaman, TFI
Stephen MacDonald, TFI
Andrew Gradus, TFI
Cindy Wilson, TFI
Kathleen Tunson, TFI
Christine Doyle, Senior Counsel, TFI (via phone)
Allan Emkin, Pension Consulting Alliance (PCA)
Andrea Feirstein, AKF Consulting (via phone)
Jeff Van Orden, Milliman USA (via phone)
Linda McAtee, General Counsel, State Treasurer's Office (STO)

The Chair declared a quorum present.

Board Agenda Item Number One
Minutes from July 15, 2004 Meeting

The minutes from the July 15, 2004 SIB meeting were approved as submitted. Members Dithridge and Serna abstained from voting as they were not in attendance at the July meeting.

Board Agenda Item Number Two Staff Report

Ms. Carrie Douglas Fong, SIB, presented the Staff Report to the Board and provided account and asset totals for the ScholarShare Program. Ms. Douglas Fong stated that Staff was very concerned that TFI would not reach its new unique account benchmark for 2004 and it is likely they will not reach the new account total they had in 2003. SIB's 529 consultant Andrea Feirstein, AKF Consulting, is currently reviewing the marketing benchmarks and may recommend that the asset goal be significantly increased and the account goal be somewhat decreased to reflect national numbers. This item will be presented to the Board at the November meeting.

Ms. Douglas Fong reported that the review of national 529 plans by the Securities and Exchange Commission (SEC) has not been completed, and the National Association of Securities Dealers (NASD) is currently investigating 15 firms (18 different plans), which do not include TFI. In a recent Senate Intergovernmental Affairs subcommittee meeting, the chairman recommended that the states cease to have a role in managing the plans and the federal oversee them.

Ms. Douglas Fong reported that Staff is working with TFI to implement the voluntary disclosure principles developed by the College Savings Plan Network (CSPN) by January 2005. Mr. Chris Lynch, TFI, stated that the disclosure information would not be different, but more obvious and understandable.

Ms. Douglas Fong stated that Carla Raffin, TFI, will be transferring from her position as program manager to a different position at TFI as of January 1, 2005. TFI will involve the Board and Staff in the hiring process for her replacement.

Marketing Update by TFI

Mr. Lynch stated that TFI shares Staff's concern regarding the growth of new unique accounts. He reported that TFI has been spending funds in excess of the contract amount to help ScholarShare grow. Mr. Lynch stated that as the 529 marketplace has matured, growth and account generation have decreased consistently across all TFI-managed 529 plans. Mr. Lynch stated that factors for this trend include the presence of more competition and the current 529 scandals. Ms. Douglas Fong reported that although TFI and other vendors have been struggling during the first six months this year as compared to last year, however, Vanguard and Fidelity have been showing healthy growth, which Staff believes is due to their strong brand name and distribution practices.

Board Members recommended looking at different and more effective marketing strategies. Mr. Kevin Seaman, TFI, discussed the marketing tactics that TFI has been utilizing as well as future marketing tactics such as Direct Response Television and incentives for current account owners.

Chair Eliopoulos inquired as to how the Back-to-School campaign has been progressing and Mr. Lynch stated that the media outreach events, television coverage and newspaper articles have been excellent; however, TFI is disappointed with the results of the campaign. Mr. Lynch added that additional press events would be held around the state during the remainder of the year.

Mr. Lynch stated that California is TFI's largest 529 plan in both assets and accounts; however, California experienced the biggest decline from last year among TFI-managed 529 plans, possibly due to greater competition in California.

Ms. Serna requested to see results for the campaigns at the next meeting. Ms. Douglas Fong stated that information regarding account generation would be included in the quarterly report that TFI provides, which will be forwarded to the Board as soon as Staff receives it. Member Dithridge stated that he was happy to see outreach to existing account owners.

Board Agenda Item Number Three
Resolution to Approve Administrative Services Contract with the State Treasurer's Office for Fiscal Year 2004-2005

Mr. Dennis Siebert, SIB, presented a resolution to approve the annual administrative services contract with the State Treasurer's Office (STO) to provide SIB with administrative support services for fiscal year 2004-2005.

Board Action:

Member Serna moved to approve the resolution authorizing the Executive Director to enter into an administrative services contract with STO for an amount not to exceed \$130,000 for fiscal year 2004-2005. The motion was seconded by Member Jones and approved by the Board.

Board Agenda Item Number Four
Resolution to Issue Request For Proposal for Investment Consultant

Ms. Douglas Fong presented a resolution to issue a Request For Proposal for an investment consultant to aid SIB in administering the Golden State ScholarShare College Savings Trust.

Board Action:

Member Dithridge moved to approve the resolution authorizing the Executive Director to issue a Request For Proposal for an investment consultant. The motion was seconded by Member Jones and approved by the Board.

Board Agenda Item Number Five
Resolution to Issue Request For Proposal for 529 Consultant

Ms. Douglas Fong presented a resolution to issue a Request For Proposal for a 529 industry consultant to aid SIB by providing a national perspective on industry standards, project guidance, and an informed opinion on marketing plans, performance and strategies.

Board Action:

Member Jones moved to approve the resolution authorizing the Executive Director to issue a Request For Proposal for a 529 industry consultant. The motion was seconded by Member Serna and approved by the Board.

Board Agenda Item Number Six
Consideration of Changes to Maximum Contribution Limit
for the Golden State ScholarShare College Savings Trust for 2005

Mr. Lynch presented TFI's recommendation for increasing the maximum account balance limit for ScholarShare from \$275,000 to \$285,000. This recommendation was based on the current methodology used for calculating the maximum account balance limit. Mr. Lynch reported that TFI's recommendation used Stanford University in the methodology, however, TFI later found that Harvey Mudd College was in fact the most expensive higher education institution in California. TFI stated they believe Stanford University is still an appropriate benchmark and \$285,000 is a reasonable maximum account balance limit.

Board Action:

Member Jones moved to approve an increase in the maximum account balance limit for ScholarShare from \$275,000 to \$285,000. The motion was seconded by Member Cox and approved by the Board.

Board Agenda Item Number Seven
Consideration of Changes to TIAA-CREF Investment Personnel

Ms. Douglas Fong stated that according to SIB's contract with TFI, changes in TIAA-CREF's investment fund management require approval by the Board. Linda McAtee, STO, noted that Item 48 of the contract states that vacated positions shall be filled with key professionals of comparable skill, experience, and reputation and that the Board is responsible for making determinations of the performance of key professionals and requesting replacements. There are no provisions about what would happen should SIB not approve the changes.

Ms. Douglas Fong stated that Staff and PCA were concerned and disappointed that TFI would not be selecting new managers for the Growth & Income Fund until December 2004 and that TIAA-CREF's fund managers have recommended including a fund that has been on probation for over 15 months, the Growth Equity Fund, in the asset allocation for 2005 (Agenda Item 9).

Mr. Allan Emkin, PCA, stated that PCA recommends approving the changes to TIAA-CREF's investment fund management with close monitoring. Mr. Emkin stated that investment performance has improved, but continues to not meet expectations.

Based on TIAA-CREF's large number of personnel changes, investment performance, investment decisions, such as its decision to wait on selecting new managers for the Growth &

Income Fund, and recommendations, such as its asset allocation recommendation (Agenda Item 9) to replace the Growth & Income Fund with the Growth Equity Fund, the Board expressed reservations about the caliber of TIAA-CREF's investment managers and agreed that it was not ready to approve the changes to TIAA-CREF's investment fund management at this time and that Staff would work with the Chair to bring this item back at the appropriate time.

Board Agenda Item Number Eight
Review and Analysis of TIAA-CREF's Second Quarter 2004 Investment Performance

Mr. Emkin presented the Board with the Fund Performance Status Report through June 30, 2004, explaining that the Social Choice Equity, Equity Index, Large-Cap Value Index, Small-Cap Blend Index, International Equity and Bond Plus funds are all currently in the "positive" range relative their benchmarks, and that the Growth Equity and Growth & Income Funds remain on probation.

Board Agenda Item Number Nine
Consideration of Changes to the Investment Policy and Asset Allocations for the Age-Based and Equity Options for the Golden State ScholarShare College Savings Trust for 2005

Ms. Douglas Fong stated that TFI provided asset allocation recommendations for 2005 that consisted of two alternatives, one of which included Real Estate Investment Trusts (REITs) and Inflation-Protected Bonds (TIPs) (Alternative 1), and one which did not (Alternative 2). PCA provided a recommendation that concurred with Alternative 2 of TFI's recommendation and proposed one additional change recommending that the Growth Equity Fund in the 100% Equity Option be replaced with an index fund of similar characteristics. Ms. Douglas Fong and PCA expressed disappointment that TFI recommended replacing the Growth & Income Fund with the Growth Equity Fund, which has been on probation for over 15 months. Mr. Jeff Van Orden, Milliman USA, added that Milliman USA independently arrived at the same recommendation as PCA.

Ms. Douglas Fong explained that the Board would only be voting on changes to the Investment Policy. Ms. McAtee recommended that, in addition to the changes to the Investment Policy, the reference to the legal opinion be removed from the Investment Policy.

Mr. Andrew Gradus, TFI, stated that if approved, this asset allocation would be implemented in 30-45 days and the Disclosure Booklet would be revised and redistributed.

Chair Eliopoulos expressed concern over the two funds on probation and wanted the record clear that the Treasurer's opinion was that the Board is making a determination on these two active funds, the Growth Equity Fund and the Growth & Income Fund, and that these funds are being moved out of the portfolio for performance reasons.

Board Action:

Member Dithridge moved to approve changes to SIB's Investment Policy, with the sentiment

that the Board is moving the two active funds, the Growth Equity Fund and Growth & Income Fund, out of the portfolio due to performance reasons, and to strike the phrase “In a written, numbered and citable (but unpublished) opinion, the Attorney General for the State of California has indicated that” from the Authorized Investments section on page 1 of the Investment Policy and changing that sentence to now read “The money in the Trust is not State money, and, therefore, not subject to statutory and constitutional restrictions that apply to State funds.” The motion was seconded by Member Jones and approved by the Board.

Board Agenda Item Number Ten **Investment Peer Review**

This item was deferred to the November 18, 2004 SIB meeting.

Board Agenda Item Number Eleven **Mid-year Review of TIAA-CREF Tuition Financing, Inc. Administrative Performance for 2004**

Ms. Marian Cohen, SIB, presented the mid-year review of TFI’s 2004 administrative performance and stated that TFI’s annual administrative performance would be reviewed at the beginning of next year. Ms. Cohen reported that for the second quarter of 2004, TFI was able to provide data for 46 of the 49 administrative performance criteria, and although there was improvement in some areas, TFI continues to underperform some of the benchmarks. Chair Eliopoulos expressed concern about the Financial and Service Correspondence timeliness performance areas, which are currently performing below the benchmarks, and encouraged improvement.

Board Agenda Item Number Twelve **Consideration of Changes to Administrative Performance Criteria for 2005**

Ms. Douglas Fong stated that the proposed changes to the administrative performance criteria are either clarifying or technical in nature with one substantial change. There were other changes proposed by TFI that Staff did not agree with, such as the exclusion of typographical errors from the New Account Set-up accuracy benchmark. Ms. Cohen stated that TFI expressed concern that the New Account Set-up accuracy benchmark was higher than industry standards, with which Staff and Ms. Feirstein disagreed.

Ms. Cohen explained that the one substantial change was that the Non-Financial Correspondence timeliness benchmark be changed from 3 days to 5 days (95%) and from 7 days to 10 days (100%). Member Jones expressed concern over this change particularly having 10 days for Non-Financial Correspondence timeliness. Ms. Cohen stated that these proposed changes to the performance criteria would be at no additional charge, and that TFI would be able to provide complete data beginning January 1, 2004, which could then be compared with data for 2005. Chair Eliopoulos inquired as to whether TFI would be able to report on all performance criteria should the Board approve the proposed changes. Ms. Cindy Wilson, TFI, responded that with

the proposed changes to the benchmarks, TFI would be able to report on 100% of the performance criteria at no additional charge to the Board.

Board Action:

Member Serna moved to adopt the changes to the performance criteria with implementation effective January 1, 2005 as proposed by TFI and Staff. The motion was seconded by Member Dithridge and approved by the Board.

Board Agenda Item Number Thirteen
Discussion of ScholarShare Strategy

This item was deferred to the next meeting.

Public Comment

Chair Eliopoulos called for public comment. There was none. There being no further business before the Board, the Chair adjourned the meeting at 11:30 a.m.

The next meeting is scheduled for November 18, 2004 at 1:00 p.m.

Respectfully submitted by,

Carrie Douglas Fong, Executive Director
SCHOLARSHARE INVESTMENT BOARD