

**MINUTES
SCHOLARSHARE INVESTMENT BOARD**

August 20, 2009, 12:00 p.m.

Chair Patricia Wynne called the meeting to order at 12:07 p.m.

- Present: Patricia Wynne for Bill Lockyer, State Treasurer
Thomas Sheehy for Michael C. Genest, Department of Finance
Dena Wilson for Glen Thomas, Office of the Secretary of Education
Antoinette Chandler
Allison Jones
Denise Fairchild
- Staff: Zeny M. Agullana, Executive Director, ScholarShare Investment Board (SIB)
Arlene Greene, Deputy Director, SIB
Stanley Zeto, SIB
Brian K. Aguilar, SIB
Samantha Evans, SIB
Samantha Smith, SIB
Kristin Smith, Staff Counsel, State Treasurer's Office
- Consultants: Jeremy Thiessen, Senior Vice President, Pension Consulting Alliance, Inc. (PCA)
Andrea Feirstein, Managing Member, AKF Consulting LLC (AKF)
(via teleconference)
- Fidelity: Jeff Troutman, Vice President, College Planning, Fidelity Investments
Institutional Services
Peter Mahoney, Vice President, Relationship Manager, Fidelity Investments
(Fidelity)
Andrew Dierdorf, Portfolio Manager, Fidelity
Sharon Rogers, Director, Marketing, Fidelity
- Public: Erin V. Peth, Deputy Attorney General, Government Law Section, Office of the
Attorney General
Ted Prim, Deputy Attorney General, Government Law Section, Office of the
Attorney General
Amy Sherman, Associate Vice President, Policy and Strategic Alliances, Council
for Adult and Experiential Learning (CAEL)

The Chair declared a quorum present at 1:10 p.m. following the presentation by the Attorney General's Office.

Board Agenda Item Number One
Presentation by the Attorney General's Office Regarding the Application of Conflict-of-Interest Laws to Board Actions

Representatives from the Attorney General's Office provided the ScholarShare Investment Board (SIB or Board) with an overview on the application of conflict-of-interest laws to Board actions. The presentation was specific to Board members.

Board Agenda Item Number Two
Approval of Minutes from March 27, 2009 Meeting

The minutes from the March 27, 2009 SIB meeting were presented to the Board.

Board Action:

Member Sheehy moved to approve the item before the Board, the minutes from the March 27, 2009 SIB meeting. The motion was seconded by Member Chandler and approved by the Board.

Board Agenda Item Number Three
Executive Director's Report

Mr. Stanley Zeto, SIB, provided updated account information for the ScholarShare Direct Plan and Advisor Plan. Ms. Zeny M. Agullana, SIB, provided an update on legislation and an overview of recent outreach efforts including upcoming events scheduled for College Savings Month in September. Ms. Arlene Greene, SIB, provided an update on the FY 09-10 budget which allows for three additional staff positions and an increase in the marketing budget. Staff is working to develop a spending plan for Board review.

Mr. Zeto provided an update on contracts. The existing contract with the program manager of the Governor's Scholarship Programs (GSP), currently TIAA-CREF Tuition Financing, Inc., is scheduled to expire in June 2010. With the Board's concurrence, SIB will request a longer term contract from the Department of General Services (DGS) when issuing the new request for proposals (RFP) for these services. The Board gave general consensus for an extended term on the GSP contract.

Ms. Greene provided an update on GSP and stated that the statute does not allow SIB to close inactive or low balance GSP accounts without a voluntary forfeiture until the beneficiary reaches the age of 30. Chair Wynne stated that in an effort to minimize administrative costs, SIB is implementing efficiencies encouraging voluntary forfeitures for low balance and inactive GSP accounts. Ms. Greene stated that there are currently approximately 68,000 GSP accounts, which include 2,500 accounts with balances of less than \$50, and a few thousand accounts with a balance of \$100 or less. In response to Chair Wynne's inquiry regarding the effect on the General Fund, Ms. Greene stated that when the GSP accounts are forfeited, the money reverts to the General Fund. Additionally, Ms. Greene added that funds set aside for unclaimed scholarships have now been reverted to the General Fund.

Ms. Andrea Feirstein, AKF, provided an update on the 529 market. Ms. Feirstein stated that the first quarter is typically the slowest period for account generation and that ScholarShare assets were down during the first quarter slightly more than the national average. Ms. Feirstein reported that during the second quarter, ScholarShare account growth increased at a faster pace than other state 529 plans.

Ms. Feirstein addressed HR 1351, stating that California has been extremely supportive, and reported that the Middle Class Task Force (MCTF) is looking for a sweeping change of the 529 plans and how to make them more effective and reliable. The Administration is troubled by the plan losses and questions the level of outreach to low and moderate income families. The Treasury requested specific 529 plan data from all states.

Member Fairchild inquired as to whether ScholarShare is effectively reaching underrepresented groups, specifically in the Los Angeles area. Member Jones stated that the California State University system participates in a number of efforts aimed at these groups, but that it is difficult to track the success of these efforts.

Member Sheehy inquired about the guaranteed products in 529 plans. He questioned why the federal government would want to mandate this since investors make their own risk and return choices for their respective plans. Ms. Feirstein stated that offering a guaranteed product would make the federal government liable for any losses. Member Sheehy inquired as to how many states Ms. Feirstein works with and how many of those states offer a guaranteed product. Ms. Feirstein stated that she works with 27 states, and of those, eight to ten offer some sort of guaranteed product. Overall, there are 51 direct-sold plans that offer a guaranteed option or product. Mr. Peter Mahoney, Fidelity, added that Fidelity is currently working on a FDIC-insured product anticipated to launch sometime during the third quarter 2010.

Board Agenda Item Number Four
Resolution to Approve Interagency Agreement with the State Treasurer's Office for
Administrative Services for Fiscal Year 2009-2010

Mr. Zeto presented Resolution No. 2009-07, authorizing the Executive Director to enter into an interagency agreement for administrative services with the State Treasurer's Office (STO).

Board Action:

Member Sheehy moved to approve the item before the Board, Resolution No. 2009-07, approving the administrative services contract with the STO for fiscal year 2009-2010. The motion was seconded by Member Wilson and approved by the Board.

Board Agenda Item Number Five
Resolution to Approve ScholarShare Investment Board Office Relocation Project

Ms. Agullana presented Resolution No. 2009-08 authorizing the Executive Director to approve the SIB office relocation project.

Board Action:

Member Sheehy moved to approve the item before the Board, Resolution No. 2009-08, authorizing the Executive Director, to prepare, execute and take the necessary steps to obtain all required approvals for the SIB office relocation project in an amount not to exceed \$400,000. The motion was seconded by Member Wilson and approved by the Board.

Board Agenda Item Number Six
Resolution to Approve Issuance of Request for Proposals for Audit Services for the ScholarShare Investment Board

Mr. Zeto reported that SIB's current contract with Gilbert Associates, Inc. for audit services is scheduled to expire in June 2010. Mr. Zeto presented Resolution No. 2009-09 authorizing the Executive Director to issue a RFP for audit services

Board Action:

Member Sheehy moved to approve the item before the Board, Resolution No. 2009-09, authorizing the Executive Director to issue a RFP for audit services for the Board. The motion was seconded by Member Chandler and approved by the Board.

Board Agenda Item Number Seven
Resolution to Approve Changes to the ScholarShare Outreach and Public Education Plan Sponsorship Selection Criteria

Ms. Greene presented Resolution No. 2009-10, requesting changes to the ScholarShare Outreach and Public Education (SCOPE) plan sponsorship selection criteria. Ms. Greene stated that the SCOPE plan was developed and approved by the Board last year to guide partners, sponsorships, and marketing efforts.

Member Sheehy inquired as to the effect of the recommended change and how the criteria were weighted. Ms. Greene stated that the original plan had a scoring system that proved to be difficult and inconsistent with evaluating the wide variety of sponsorships and outreach activities SIB entertains and that the recommended change would allow for more flexibility.

Board Action:

Member Jones moved to approve the item before the Board, Resolution No. 2009-10, approving changes to the sponsorship selection criteria of the SCOPE plan. The motion was seconded by Member Sheehy and approved by the Board.

Board Agenda Item Number Eight
Update on the California ScholarShare Advancement Vehicle for Education (CalSAVE)

Ms. Greene and Mr. Brian K. Aguilar, SIB, presented an update on the implementation of CalSAVE and stated that SIB staff is pursuing a pilot project while simultaneously developing program regulations.

Board Agenda Item Number Nine
Overview of Lifelong Learning Accounts (LiLA)

Amy Sherman, Associate Vice President, CAEL, presented information on LiLAs.

Member Chandler inquired about the tax benefits of LiLAs. Ms. Sherman stated that principal and interest earnings can grow tax-free.

Chair Wynne inquired about providing employment counseling to account holders and Ms. Sherman suggested a possible partnership between non-profit organizations, community colleges or career centers. Member Jones inquired if the intent was to invest funds in a 529 plan and Ms. Sherman responded that there is a savings component and the intent is to use low risk 529 plans.

Member Fairchild inquired as to the expected penetration rate in California and availability of resources to which Ms. Sherman stated that there is a demonstration in San Francisco and that IBM has set up a matched learning account.

Member Sheehy stated that in terms of program administration, CAEL should consider the Employment Development Department (EDD). Ms. Sherman stated that CAEL has spoken with EDD and they are very supportive of LiLAs.

Chair Wynne requested that SIB staff prepare an agenda item for a future Board meeting to evaluate pros and cons to administering the program.

Board Agenda Item Number Ten
Review and Analysis of Fidelity Investment's Investment Performance for the ScholarShare Advisor Plan for the Second Quarter 2009

Mr. Andrew Dierdorf, Fidelity, presented Fidelity's "Advisor Plan Investment Performance Review" for second quarter 2009. Mr. Dierdorf noted that the markets have moved forward in a positive way and that the college portfolios experienced a rebound in March 2009.

Mr. Jeremy Thiessen, PCA, presented PCA's "Advisor Plan Investment Performance Status Report" for second quarter 2009. Mr. Thiessen stated that PCA evaluated the Fidelity funds relative to the benchmarks. Mr. Thiessen also noted that during the second quarter, PCA does not have any major concerns with the fund allocation based on historical trends.

Member Chandler inquired about the performance of the benchmark and the manager deviation from that index. In response to the Board's inquiry regarding deviations, Mr. Thiessen stated that an explanation can be provided when a fund moves out of the acceptable status and that PCA would provide further information when a fund moves into the caution status. Member Chandler requested that information on deviations be provided on a quarterly basis to the Board. Mr. Dierdorf stated that Fidelity is working toward quarterly updates.

Chair Wynne inquired about how many quarters of caution status before an issue is raised. Mr. Thiessen stated that per the monitoring procedures and criteria, PCA reviews three years of performance data prior to placing any fund on watch.

Member Sheehy inquired if the High Yield Asset Class is fixed income or mixed. Mr. Dierdorf stated that on the advisor side, Fidelity has one fund in the High Yield Asset Class, the Advisor High Income Advantage Fund, which is more aggressive and takes more risk than the benchmark, and it is exclusively fixed income. Mr. Dierdorf stated that Fidelity is looking at bringing in another high yield fund to balance out risk with a recommendation anticipated at the October Board meeting.

Board Agenda Item Number Eleven

Review and Analysis of Fidelity Investments' Performance for the ScholarShare Direct Plan for Second Quarter 2009

Mr. Thiessen presented PCA's "Direct Plan Investment Performance Status Report" for second quarter 2009. Mr. Thiessen reported that the Active High Yield Asset Class was in the acceptable range. Mr. Dierdorf addressed the high yield returns stating that there are two high yield funds under the Direct Plan versus only one high yield fund under the Advisor Plan.

Mr. Dierdorf specifically addressed the performance of the Passive International Equity Asset Class, which is currently in caution status. Mr. Dierdorf discussed fair value adjustments and how they affect the performance numbers provided in the reports. Member Sheehy inquired how this information explains the "trend". Mr. Dierdorf stated that the benchmark does not change or make adjustments for the fair value adjustments. Member Chandler inquired as to whether the fair value adjustment is 100% attributed to the tracking error. Mr. Dierdorf stated that approximately 98% of the adjustment is attributed to the tracking error and that Fidelity is working to provide better disclosure in this area. Mr. Thiessen stated that PCA has proposed adding a footnote of explanation and has requested information from Fidelity.

Mr. Dierdorf addressed the investment performance results, noting that the index funds outperformed the active funds in the Direct Plan during first quarter 2009. Member Sheehy inquired if the total returns had taken into account differences in costs between index and active funds. Mr. Dierdorf stated that performance data presented is net of fees.

Board Agenda Item Number Twelve
Review of Fidelity Investment's Administrative Performance for the ScholarShare Direct Plan and Advisor Plan for Second Quarter 2009

Mr. Peter Mahoney, Fidelity, presented Fidelity's "Quarterly Administrative Benchmark Performance" report for second quarter 2009. Mr. Mahoney noted that only one area underperformed the benchmark by more than 2% during second quarter. Mr. Mahoney stated that the timeliness performance criterion has improved in several areas, including non-financial correspondence and new account setup.

Mr. Mahoney noted that the Customer Experience Index (CEI) has been an ongoing issue but that Fidelity has seen some improved data in the loyalty studies. Member Jones inquired about the percentage of callers responding to the survey. Mr. Mahoney stated that approximately 60% of callers respond.

Mr. Jeff Troutman, Fidelity, presented the "Quarterly Administrative Benchmark Performance" report for the Advisor Plan for second quarter 2009. Mr. Troutman stated that the Advisor Plan performance metrics are reviewed at an aggregate level. Ms. Agullana noted that the Advisor Plan benchmarks have been added to the report for information only.

Board Agenda Item Number Thirteen
Fidelity Investment's Marketing Update for the ScholarShare Advisor Plan

Mr. Troutman provided an overview of marketing performance from a national perspective for the Advisor Plan.

Member Sheehy inquired about bond spreads being at a historic high and what that means. Mr. Dierdorf noted that the bond spread measures the yield of a bond relative to treasury bonds and that last year, bond spreads were at historic highs during the credit crisis. Member Chandler added that bonds were very inexpensive during the crisis and now costs are increasing.

Mr. Troutman reported that 34% of parents have decreased the amount that they are saving for college. Member Jones stated that they have seen an exponential increase in the number of students applying for financial aid. Member Sheehy added that he was shocked at the rate of inflation for college education. Member Jones reported that Congress is reviewing the increases in tuition and fees as this has been a major issue with the House Education Committee the last two years. The committee believes that there is an apparent link between cost increases and the availability of financial aid.

Member Sheehy inquired how many advisors are selling Fidelity's mutual funds. Mr. Troutman estimated 20-25%. Member Sheehy stressed the importance of brand marketing with the Fidelity and ScholarShare name. Mr. Troutman added that based on a market metrics statistics, brand is one of the most important characteristics of a firm and that Fidelity's brand has always ranked in the top three.

Member Chandler inquired how the Morgan Stanley/Smith Barney joint venture was affecting the selling agreement and what that means in terms of potential penetration. Mr. Troutman stated that Fidelity was hopeful that the merger would increase opportunity at Smith Barney. Mr. Troutman added that currently Smith Barney does not have a selling agreement to sell the ScholarShare plan. Fidelity is also looking at longer term opportunities with Edward Jones.

Board Agenda Item Number Fourteen

Fidelity Investment's Marketing Update for the ScholarShare Direct Plan

Mr. Mahoney reviewed Fidelity's "Mid-Year Marketing Update" for the first half of 2009. He reported that Fidelity's theme is to rebuild investor confidence and that a national brand campaign took place during the first half of 2009. Mr. Mahoney highlighted that the total accounts increased year over year with net sales for the second quarter of 2009 versus the second quarter of 2008, decreasing by 39% while the industry decreased by 41%. Mr. Mahoney reported that in terms of total assets for the year, the industry was down 11% while ScholarShare was down 5%.

Ms. Sharon Rogers, Fidelity, addressed advertising mediums and noted that the display campaign has generated 140 trackable new accounts to date this year, versus 31 accounts last year. Ms. Rodgers highlighted some of the strongest performing websites, including Nick Jr.

Member Sheehy inquired about the size of the ScholarShare logo. Ms. Agullana stated that SIB staff would look at revising the logo to make it more prominent.

Member Fairchild inquired about the foster care pilot program implementation. Ms. Greene stated that it would take at least one year to implement, and the Board would receive regular updates.

Public Comment

Chair Wynne called for public comment. There was none.

There being no further business before the Board, the Chair adjourned the meeting at 4:09 p.m.

Respectfully submitted by,

Zeny M. Agullana, Executive Director
ScholarShare Investment Board