# MINNESOTA STATE BOARD OF INVESTMENT MEETING

**June 8, 1994**

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# INVESTMENT ADVISORY COUNCIL MEETING

**June 7, 1994**

**AGENDA**
**STATE BOARD OF INVESTMENT**
**MEETING**
**Wednesday, June 8, 1994**
**8:30 A.M. - Room 125**
**State Capitol - Saint Paul**

| | TAB |
|---|---|
| **1. Approval of Minutes of March 2, 1994** | |
| **2. Report from the Executive Director (H. Bicker)** | |
| A. Quarterly Investment Review (December 31, 1993 - March 31, 1994) | A |
| B. Portfolio Statistics (March 31, 1994) | B |
| C. Administrative Report | C |
| 1. Budget report | |
| 2. Travel report | |
| 3. Update on 1994 Legislation Session | |
| 4. SBI/IAC meeting schedule for remainder of calendar 1994 | |
| 5. Issues to be referred to the Deferred Compensation Review Committee | |
| **3. Reports from the Investment Advisory Council (J. Yeomans)** | |
| **A. Stock and Bond Manager Committee** | D |
| 1. Review of manager performance for period ending 3/31/94 | |
| 2. Update on candidates for Manager Monitoring Program | |
| 3. Annual review of investment manager guidelines | |
| 4. Report from the Passive Manager Review Committee | |
| 5. Recommendation to use the Lehman Aggregate | |
| 6. Recommendation concerning the management structure of the Assigned Risk Plan | |
| **B. Alternative Investment Committee** | E |
| 1. Results of annual review sessions | |
| 2. Commitment to a new real estate manager (CB Commercial) | |
| 3. Commitment to a new private equity manager (Hellman & Friedman) | |
| **4. Report from the SBI Administrative Committee (M. McGrath)** | F |
| 1. Approval of Executive Director's Work Plan for FY95 | |
| 2. Approval of Budget Plan for FY95 | |
| 3. Approval of Continuing Fiduciary Education Plan | |
| 4. Approval of process for Executive Director's FY94 evaluation | |
| 5. Approval of preliminary FY96-97 biennial budget request | |
| 6. Authorization of contract amendment with State Street Bank | |
| 7. Approval of monitoring process for International Investing Guidelines | |
| 8. Consideration of re-negotiated contracts for the Deferred Compensation Plan | |

# Minutes
# State Board of Investment
# March 2, 1994

The State Board of Investment (SBI) met at 8:30 A.M. on Wednesday, March 2, 1994 in Room 125, State Capitol, St. Paul, Minnesota. Governor Arne H. Carlson, Chair; State Auditor Mark B. Dayton; State Treasurer Michael A. McGrath; Secretary of State Joan Anderson Growe and Attorney General Hubert H. Humphrey III were present.

Mr. Carlson called the meeting to order and the minutes of the December 15, 1993 meeting were approved.

**Executive Director's Report**
Mr. Bicker, Executive Director, referred members to Tab A of the meeting materials and reported that the Combined Funds, Basic Funds and Post Fund had all outperformed their respective return objectives over the period.

He stated that the Basic Funds are now over $10 billion in size and that the Basics' asset mix is on target with its long-term asset allocation policy. He said that the Basic Funds had underperformed for the quarter (Basics 1.2% vs. Composite 1.6%) but had outperformed for the year (Basics 12.2% vs. Composite 12.0%), three year (Basics 14.8% vs. Composite 14.0%) and five year periods (Basics 12.8% vs. Composite 12.1%).

Mr. Bicker reported that the Post Retirement Fund was just under $9 billion as of December 31, 1993. He stated that the Post Fund's allocation to international stocks was fully funded during the quarter. He said that the total fund had matched its composite index at 1.4% for the quarter and had exceeded it since 7/1/93 (Post Fund 5.0% vs. Composite 4.6%).

Mr. Bicker distributed a handout (see **Attachment A**) and stated that it included a revised performance figure for the international stock component since inception. He added that the international component actually had outperformed its target since inception and not underperformed as stated in the meeting materials. Mr. Bicker reported that the domestic stock manager group had underperformed the Wilshire 5000 for the quarter (Domestic Stocks 1.4% vs. Wilshire 5000 2.1%) and year (Domestic Stocks 10.9% vs. Wilshire 5000 11.0%). Mr. Bicker said that the majority of the segment's underperformance was due to negative tracking error by the passive manager and he added that this would be addressed later in the meeting during the Stock and Bond Manager Committee Report. In response to a question from Mr. Carlson, Mr. Bicker clarified that the tracking error only involves the equities that are passively managed. He stated that the international stock manager group had exceeded its target for the quarter (International Stocks 4.0% vs. EAFE 0.9%) and year (Int'l. Stocks 34.3% vs. EAFE 32.6%). Mr. Bicker stated that the domestic bond manager group had outperformed for both the quarter (Domestic Bonds 0.1% vs.

Salomon BIG 0.0%) and year (Domestic Bonds 11.5% vs. Salomon BIG 9.9%). Mr. Bicker reminded members that all SBI reported returns are net of fees. Mr. Carlson voiced his approval of the investment results.

Mr. Bicker reported that the Assigned Risk Plan (ARP) had underperformed its composite index for the quarter (ARP 1.1% vs. Composite 1.3%) but outperformed it for the year (ARP 7.1% vs. Composite 6.4%). Mr. Bicker stated that staff has some concerns regarding the equity portion of the ARP and had recommended that the equity portion be indexed. He added that the Stock and Bond Manager Committee did not oppose staff's recommendation, however, he noted that the Committee did have some additional alternatives they felt should be reviewed. Therefore, he said, further analysis would occur during the following quarter and a recommendation would be presented to the Board at the June 1994 meeting. He said that as of December 31, 1993 the SBI was responsible for nearly $23 billion in assets.

**Executive Director's Administrative Report**

Mr. Bicker referred members to Tab C of the meeting materials for the current budget and travel reports and he noted an additional agenda item concerning the review of vendors for the retirement plans administered by the State University and Community College Systems.

In response to questions from Mr. Carlson, the discussion returned to the SBI's investment performance and Mr. Bicker confirmed that over the most recent 1, 3, 5, and 10 year periods the SBI's performance would be near the 40th percentile in the TUCS Universe. He added that for the most recent 5 year period, the Basics had outperformed its composite index by 0.7% (Basics 12.8% vs. Composite 12.1%). Mr. Dayton noted that a year ago the returns were slightly below the TUCS median. In response to further questions from Mr. Carlson, Mr. Bicker stated that he feels comfortable with the SBI's current asset allocation and investment management structure. He said, however, that if the Board wishes to achieve returns that would place the SBI in the top quartile, he believes that the SBI would need a 75% allocation to common stocks, which would result in increased volatility. He also added that it would probably be necessary to use a market timing strategy, which is not feasible due to the size of the SBI's assets. Mr. Bicker reviewed the various goals and objectives that have been established by the Board noting that the SBI has a relatively aggressive investment posture. He said that the addition of international stock, private equity investments, and the emerging manager program should provide the SBI with additional opportunities to add value to the Funds.

In response to questions from Mr. Carlson, Ms. Yeomans stated that 3M's assets are substantially smaller in size than the SBI's. She said that some private funds, similar in size to the SBI, have established independent subsidiaries of their corporations and have staffed them like investment management firms. She cited GTE and GE Corp. as examples. She stated that this type of management structure is totally different from the SBI and she noted the additional costs associated with paying investment management staff of that caliber. Mr. Dayton stated that though he had voiced some criticism regarding the SBI's investment performance when he initially took office, that he feels that the progress made in the last couple years has been remarkable and he commended staff, the IAC and the Board on undertaking numerous manager searches and structuring the funds in a more diversified manner. He stated that the tracking error of the index manager suggests that passive management is not a guarantee of success. He added that any amount of incremental return adds up to significant dollars given the size of the SBI's assets under management.

Mr. Bicker referred members back to Tab C and resumed his discussion of the SBI's responsibility to review and approve vendors for the individuals retirement plans administered by the State University System and the Community College System. He stated that the recommendation had been revised from what was included in the meeting materials and that staff is recommending a one year extension to the contract with the current vendors in order for the re-bidding of the contracts to coincide with the merger of the State University System, Community College System and Technical Colleges Boards scheduled to take place on July 1, 1995. Mr. Dayton stated he was comfortable with that recommendation provided that it includes a competitive bid process. Mr. Bicker confirmed that it would. Ms. Growe moved approval of the recommendation to extend the vendor contracts for one year and to competitively rebid the contracts at that time. Mr. Dayton seconded the motion. The motion passed.

**Asset Allocation Committee**
Ms. Yeomans referred members to Tab D of the meeting materials and discussed the current management structure of the stock segment of the Assigned Risk Plan (ARP). She said that currently 20% of the ARP is invested in equities by Voyageur Asset Management. She explained that initially staff felt Voyageur's investment style would broadly represent the market, but that it has proven not to do so. As a result, she said, the fund could be incurring some volatility that is not appropriate for this type of fund. She stated that staff had suggested moving the equity assets from active to passive management. She noted that while the Committee agreed that a change is warranted, they had asked staff to conduct some additional analysis on other possible alternatives. Therefore, she said, she anticipates presenting a recommendation at the June 1994 Board meeting. Mr. Dayton asked if this situation raises any questions about Voyageur's qualifications to manage the Assigned Risk Plan. Ms. Yeomans said Voyageur was selected at a time when their equity style of management was "in favor" with the market. She added that when the stock market undergoes change, Voyageur's investment style could lead to extended periods of underperformance. In response to a question from Mr. Dayton, Ms. Yeomans stated that she believes an in-depth review of Voyageur is not needed before its scheduled date and she noted that the bond segment has been managed appropriately and is not currently an area of concern. In response to questions from Mr. Carlson, Ms. Yeomans confirmed that when a manager engages in a particular investment style, it typically results in their strategy outperforming and underperforming the broad market at various points in time. Mr. Bicker stated that it is important to remember that this is an insurance company portfolio. He stressed that the SBI believes that Voyageur is a good manager, but that their style of stock management may not be appropriate for this

type of fund. Mr. Carlson commented that the SBI has made a point of hiring managers specifically for their style and he asked why Voyageur should be viewed any differently. Mr. Bicker said that the SBI utilizes multiple investment styles for the retirement funds while the ARP manager is a totally separate entity. In response to a question from Mr. Carlson, Mr. Bicker restated that staff had recommended to the Committee that the equity segment be indexed, and that the Committee had also recommended that staff evaluate some additional alternatives. In response to a question from Ms. Growe, Ms. Yeomans said that a recommendation would be made at the June 1994 meeting, after staff have completed their analysis. In response to a question from Mr. Carlson, Mr. Bicker confirmed that these different manager expectations only apply to the Assigned Risk Plan because the ARP cannot be combined with the management of any of the SBI's other funds since it is a taxable entity, while the retirement funds are tax-exempt. Mr. Carlson commented that he will listen to the analysis but believes that the end result will be that the segment is indexed.

Ms. Yeomans reported that the Committee is recommending that the Board approve the position paper on the Post Retirement Investment Fund. She added that the paper chronicles the evolution of the changes made to the Post Fund and to the benefit increase formula. Mr. Humphrey moved approval of the Committee's recommendation, as stated in the Committee Report. Ms. Growe seconded the motion. Mr. Carlson asked if the retirees had reviewed the changes discussed in the position paper. Mr. Bicker explained that all of the changes had been discussed and supported by the retirees and that they had already taken effect. He added that the position paper is just a means of formally stating in writing the policies that the Board has adopted. Mr. Whitaker, a representative of the Coalition of Retiree Organizations, agreed. The motion passed.

**Stock and Bond Manager Committee Report**

Ms. Yeomans referred members to Tab E of the meeting materials and noted that Manager Commentaries for each active manager are included in Tab H.

Ms. Yeomans reported that staff had presented the Committee with a performance update on Wilshire Asset Management, the SBI's passive equity manager. She said the update noted that the firm's tracking error had increased recently which raises concerns about Wilshire's future capabilities. She noted that Wilshire had been retained in 1983 and that the firm's last review conducted in December 1992 had been satisfactory. Ms. Yeomans reported that staff had proposed conducting a passive manager search and had also suggested that the SBI consider replacing the Wilshire 5000 with the Russell 3000 as the SBI's asset class target for domestic equities. She explained that the Russell 3000 is also a broad market index and that staff believe it may be a more appropriate target since it only includes the stocks of companies that are accessible to large institutional managers. Ms. Yeomans stated that the Committee felt that they were not prepared to make such major decisions without further review. She said the recommendation from the Committee is to establish a Passive Manager Review Committee which will evaluate both the asset class target and the passive manager alternatives. She added that, if established, the Review Committee would present a recommendation to the Board at the June 1994 meeting. Mr.

Dayton moved approval of the Committee's recommendation to establish the Passive Manager Review Committee, as stated in the Committee Report. Mr. McGrath seconded the motion. The motion passed.

**Alternative Investment Committee Report**

Ms. Yeomans referred members to Tab F of the meeting materials and stated that the Committee has recommendations for three new investments for the Board to consider. She said the first recommendation is an investment in a fund called The Realty Associates III with TA Associates Realty for $40 million or 20% of the fund, whichever is less. In response to a question from Mr. Carlson, Mr. Bicker stated that this real estate manager has performed very well, outperforming real estate indexes and making money when most real estate managers have underperformed. Mr. Dayton noted his concern with the real estate area in general. In response to a question from Mr. Dayton, Mr. Bicker stated that he believes now is a much better time to invest in real estate than it was three years ago due to the stronger economy. He emphasized that investing large sums in real estate requires more lead time than investing in the stock or bond markets and that waiting too long can result in missed opportunities for increased returns. In response to questions from Ms. Growe, Mr. Bicker stated that the Basics have approximately $524 million available for investment in alternative assets. In response to questions from Mr. Carlson, Mr. Bicker said that he believes the key in evaluating the real estate market is the state of the economy and whether lease rates can be maintained or increased. He added that no one can guarantee that the real estate market has "bottomed-out," but he said he believes it is much closer than it was before. In response to a question from Mr. Dayton, Mr. Bicker said that he believes the investment with TA Associates is capable of not only helping to diversify portfolio, but also providing the SBI with its targeted return. Mr. Humphrey moved approval of the Committee's recommendation, as stated in the Committee Report. Mr. McGrath seconded the motion. The motion passed.

Ms. Yeomans reported that the second recommendation is for a venture capital investment in Coral Partners IV. She explained that the Coral Group was formerly IAI Venture Capital Group and that the SBI has invested in previous funds. She added that many of the fund's investments are likely to be in Minnesota. Mr. McGrath moved approval of the Committee's recommendation, as stated in the Committee Report. Ms. Growe seconded the motion. The motion passed.

Ms. Yeomans stated that the third recommendation involves an additional investment with an existing private equity manager, Summit Partners in Summit Subordinated Debt Fund Limited Partnership for the Post Retirement Fund. Mr. Dayton asked if the strategy is going to be to make separate alternative investment selections for the Basics and Post Fund or if they both may invest in the same funds on a pro-rated basis. Mr. Bicker stated that since many venture capital funds do not return money for several years, staff is focusing on investments for the Post Fund that have immediate income which will be applied toward the benefit increase and "equity kickers" which will provide retirees with additional potential returns over the long-term. Mr. Carlson commented that he believes that it is important to structure each fund's participation so that there is a clear distinction regarding which investments are owned by each fund. Mr. McGrath moved approval of the Committee's recommendation, as stated in the Committee Report. Mr. Dayton seconded the motion. The motion passed.

**Administrative Committee Report**

Mr. McGrath referred members to Tab G of the meeting materials and noted that an update on the police and fire pension fund activity is included for the Board's information and review.

Mr. McGrath stated that the Committee had reviewed the contract negotiations with vendors in the Deferred Compensation Plan and he summarized the respective roles of the Minnesota State Retirement System (MSRS) and the SBI in the negotiating process. He asked Mr. Bicker to update members on the negotiations with the insurance companies and Mr. Bergstrom to give an update on the negotiations with the service organizations.

Mr. Bicker referred members to the meeting materials for a summary and comparison of the current and proposed terms of the contracts. He emphasized that the Board was not being asked to vote on the actual contracts at this meeting, but only on whether or not to accept the letters of intent from the vendors which, if approved, would allow the re-negotiation process to continue. He noted that the letters of intent are not legally binding. Mr. Bicker explained all of the proposed terms outlined in the letters of intent and how they differ from the terms that currently exist in the contracts concerning range of investment options, portability, termination provisions and marketing/service arrangements. He said that he believes the proposed terms represent substantial improvements over the current contracts. He stated that if the program was in a start-up mode, it might be possible to achieve additional improvements on some terms, but that it becomes difficult when the program already exists. He emphasized that the bottom line is how best to serve the individual participants. Mr. Bicker stated the importance of examining the exit provisions and he stated that he, Mr. Bergstrom and Ms. McCarrel are all in agreement that the participants are significantly better off under the re-negotiation situation than they would be re-bidding the contracts. He stated that some areas of potential litigation involving contract termination dates and vested commissions could be eliminated through the re-negotiation process. He pointed out that the original 1980 contract was drawn up by an actuary and included terms that were standard practice at that point in time.

Mr. Carlson asked Ms. McCarrel, the SBI deferred compensation consultant from The Wyatt Company, for her observations regarding the proposed contract terms. Ms. McCarrel stated that she believes the proposed terms are a great improvement that give participants more flexibility, i.e. more investment choices and the ability to move money from one vendor to another without being penalized by the terms in the existing contracts. Mr. Carlson asked whether there is anything included in the proposed terms that could lead people to think that MSRS is moving in the direction of totally managing the program again in-house, as it did prior to 1980. Mr. Bicker said he did not believe so. Mr. Carlson stated that he believes that issue is important because it was due to MSRS's failure in handling the marketing of the program that led to the hiring of private sector marketing firms in 1980. He added that he believes it is important to acknowledge that the two current marketing firms had increased participation by a substantial amount. Mr. Bergstrom clarified that the letters of intent are with the two existing companies and he noted that one of the goals during this process is to minimize any disruptions to the Plan. He added, however, that he believes it will always be a part of his job responsibility to review all administrative options concerning the Plan. Mr. Carlson voiced his concern that the process could be guided by Mr. Bergstrom back towards internal management by MSRS. In response to questions from Mr. Carlson, Mr. Bergstrom acknowledged the difficulties MSRS had encountered when it had marketed the Plan internally prior to 1980. Mr. Bergstrom stated that it would be the MSRS Board that would ultimately make any decisions and he clarified that he is not suggesting that MSRS should market the Plan internally. Mr. Carlson restated his discomfort on this issue. Mr. Bicker reminded members that under current statute, the State Board of Investment is responsible for all contracts related to the Deferred Compensation Plan and that even in future years any contractual arrangements on marketing will have to be approved by the SBI as well as MSRS.

Mr. Dayton stated that he believes the public record should clearly state the problems that have existed with the program and he said that, in his opinion, an unregulated monopoly had been created in 1980 that resulted in an inferior product at an inflated price. He noted the substantial basis point fee reduction that had been negotiated and stated his belief that those figures prove how excessive the marketing fees have been. He said that if the lower fees had been in force during the last five years, the Plan could have saved over $8.5 million. He noted what he feels are punitive exit provisions in the existing contracts and stated that while he believes some progress has been made, he feels that some unacceptable terms still exist.

Ms. Growe said she had concerns with the portability terms and the five year length of the contract and she asked Ms. McCarrel to give her perspective in these areas. Ms. McCarrel summarized the proposed terms on portability and explained the trade-offs associated with the interest rate levels credited to participants versus the length of the contract. She pointed out that insurance companies are only willing to credit higher interest rates if they have some assurance that they will be able to invest those assets for a set period of time. In response to a question from Mr. Carlson, Ms. McCarrel said that she is satisfied with the proposed portability terms and she noted an example of the withdrawal restrictions a bank would impose on a five year certificate of deposit as similar to the restrictions suggested by the proposed terms. In response to a question from Mr. Dayton, Ms. McCarrel explained that the fixed annuity products offered by the two insurance companies are structured very differently, i.e., Minnesota Mutual resets their rates periodically while Great-West sets their rates in advance and they remain the same for the entire certificate. She added that Minnesota Mutual's more flexible structure allows them to be able to offer the higher annual portability of 20% on fixed options. Mr. Dayton said he respected that answer but that the Board's responsibility lies with serving the best interests of the participants. Mr. Bicker reiterated that increased portability means lower credited interest rates for the participants and he discussed how insurance commissioners are monitoring portability provisions very closely to assure that they do not put an insurance company in jeopardy of losing a great deal of assets in a short period of time, i.e., avoid a "run on the bank."

Ms. Growe reiterated her concerns that a five year termination date seems too long and asked Ms. McCarrel for her opinion. Ms. McCarrel stated that the best terms with the insurance companies were available with a five year time frame. She said that shorter time frames would result in less attractive terms in other areas. Ms. Growe asked Ms. McCarrel to comment on which process she believes would best serve the participants, i.e., re-negotiation vs. re-bidding. Ms. McCarrel stated that she feels renegotiating the contracts is a better option for the participants and she reviewed some of the problems that were discussed earlier regarding re-bidding the contracts. Ms. Growe asked for Mr. Bergstrom's opinion and he also stated that MSRS believes it is better to renegotiate the contracts. In response to a question from Ms. Growe, Ms. McCarrel said that if the proposed terms are approved there are still some restrictive termination provisions but she noted that they are significantly less punitive than what exist in the current contract.

In response to questions from Mr. Carlson, Mr. Bicker reviewed the six investment options available through the Supplemental Investment Fund (SIF) and added that if legislation is approved this session, there would be an international investment option also. He stated that MSRS had recently distributed a newsletter to all participants that compared the performance of the State's investment options and the insurance companies products.

In response to questions from Mr. Dayton, Mr. Bicker said that the 1 1/8% interest rate included in the exit provisions is the standard minimum rate provided by insurance companies and that it is possible for companies to allow rates that exceed that amount. Mr. Bergstrom stated that he believes that all of the investment options for the Plan have performed very competitively over the last three to seven years. Mr. Dayton restated his concern that the portability and exit provisions in the proposed terms are still too restrictive and punitive to participants. Mr. Bicker acknowledged Mr. Dayton's views and restated his belief that if the program was being started now rather than in 1980 that more favorable terms could be negotiated. He stated that he believes the proposed terms accomplish nearly all of what staff set out to do and also provide an interim period to resolve some potential legal problems. Mr. Dayton stated that in his opinion there are four areas that remain unacceptable to him. He said he believes the portability on fixed options should be 20% for both insurance companies; that the re-investment options for the fixed products with Great-West should remain consistent with the way they were marketed under the existing contract; that the exit provisions should be negotiated in such a way so that in five years they are not as restrictive and punitive; and that any costs savings that occur as a result of the negotiations should be identified and returned to the participants. He said that he gives Mr. Bicker and Mr. Bergstrom credit for all that they had accomplished so far, but he asked that they continue to negotiate to improve the terms listed above. He added that he cannot support the terms as they stand now and he urged the other Board members to withhold their support also.

In response to a question from Ms. Growe, Mr. Bicker clarified that if the Board approves the letters of intent, their action would result in continuation of the negotiation process. He stressed that nothing approved by the Board at this time is legally binding and that his goal is to continue the negotiations and to have a contract ready for the Board's review at the June 1994 meeting. Mr. McGrath stated that he served on MSRS's negotiating committee and that he believes, along with the MSRS Board, that all of the goals established by MSRS have been achieved. He said that he hoped the Board could come to a favorable vote on this recommendation today. Mr. Dayton restated his concerns and noted that he is disappointed that the MSRS Board will not take a more aggressive stance to remedy the situation. He added that he does not want to be put in this same position in June, if further concessions can not be achieved.

Mr. Humphrey stated that he believes progress has been made through tough negotiations and that he expected those negotiations to continue. He said that while it is fine to examine what has happened in the past on this issue, that it is time to make the appropriate changes going forward that best serve the Plan participants. He noted that there is always a potential for litigation and that he believes it is best to deal with that possibility by reducing the risk of litigation to the greatest extent possible. He said that he believes the negotiation process is helping in that area. He added that he believes the letters of intent merely provide the framework within which the parties may continue their current negotiations.

Ms. Growe referred to Mr. Dayton's earlier comments about the Plan offering inferior products and she asked for Ms. McCarrel's comments. Ms. McCarrel stated that there are some limitations in some of the existing products but that she feels all the products have been very competitive. She noted that the most important criteria in determining with whom to place a fixed annuity is the solvency of the insurance company and she stated that both Great-West and Minnesota Mutual are both highly rated, secure companies and that the safety of monies invested with those companies is not an issue.

Mr. Carlson said he believes the negotiations have come a long way and that in his opinion the Board should be able to approve the re-negotiated contracts at the June 1994 meeting. In response to a question from Mr. McGrath, Mr. Bicker explained that due to all the legalities, it would be difficult to have a final contract for the Board to consider much earlier than the June meeting. Mr. Carlson stated his willingness to call a special Board meeting if the process could be expedited.

Mr. Carlson noted Representative Bob Johnson's presence and invited Rep. Johnson to share his comments with the Board. Rep. Johnson stated that he appreciated the lengthy discussion that had taken place regarding the Deferred Compensation Plan earlier in the meeting and he stated that over the years he has had concerns about the lack of accountability and MSRS's role in the management of the Plan. He said the purpose of his remarks to the Board is to request that the process be slowed down since there is a regulatory reform bill that has been introduced in the Legislature that, if it is signed into law, would have an impact on the current negotiations for the Deferred Compensation Plan. He said that he tried to raise some of the same issues regarding portability in the past but had not encountered much cooperation. He thanked the Board for the opportunity to express his comments.

Mr. Carlson asked Rep. Johnson what prevented the Legislature from exercising oversight and addressing the concerns he expressed in his comments to the Board. Rep. Johnson stated that previously there were no statutory requirements for MSRS to provide the Legislative Commission on Pensions and Retirement with information. Mr. Carlson stated that he wanted to make it very clear that it is the Legislature's responsibility to pass and change laws. Mr. Johnson agreed but noted that previously, any type of reform measures had been intensely lobbied against in the House of Representatives. In response to questions from Mr. Carlson, Rep. Johnson acknowledged that Board members had not been a party to that lobbying effort. Mr. Carlson asked if Rep. Johnson had any association with any individuals wishing to bid on this contract. Rep. Johnson responded by stating that there are companies who have sought his advice as to what would be appropriate regarding this issue. Mr. Carlson asked Rep. Johnson if he had any associations with any company that needed to be disclosed. Rep. Johnson stated that he does not believe so, however, he noted that he is a participant in the 403(b) plan and that he invests money in funds managed by Fidelity, Kemper, VALIC and the State's Supplemental Investment Fund.

Mr. Humphrey stated that he believes the timing of the Board's action in June is in sinc with the potential legislative action to which Rep. Johnson referred. Mr. McGrath agreed. Mr. Carlson noted that Rep. Johnson has had several avenues available to him to address his concerns including legislative committees and the legislative auditor and said he was concerned about negative characterizations in light of the Board's limited jurisdiction in this program. Mr. Carlson noted the complexity of the Deferred Compensation negotiations and he expressed concern that future Board members could be less inclined to take a risk to solve problems for fear that they may later be politically criticized for taking that risk. Mr. Carlson asked for a motion. Mr. Humphrey moved that the Board authorize the Executive Director to continue negotiations for the purpose of preparing a final contract to meet or exceed the terms as outlined in the letters of intent. Mr. McGrath seconded the motion. The motion passed. (After the meeting Mr. Dayton asked to be recorded as a "no" vote.)

The meeting adjourned at 10:23 A.M.

Respectfully submitted,

Howard J. Bicker

Howard J. Bicker
Executive Director

# EXECUTIVE SUMMARY
## Stock and Bond Manager Performance

### Domestic Stocks

The domestic stock manager group (active and passive combined) trailed its target for the quarter and year.

| | Qtr. | 1 Yr. | 3 Yr. | 5 Yr. |
|---|---|---|---|---|
| Dom. Stocks | **1.4%** | **10.9%** | **17.5%** | **14.1%** |
| Wilshire 5000* | 2.1 | 11.0 | 17.5 | 14.2 |

* Buy/hold index adjusted for liquor and tobacco restrictions through 3/31/93 and AHP restriction through 10/31/93.

### International Stocks

The international stock manager group (active and passive combined) exceeded its target for the quarter and year.

| | Qtr. | 1 Yr. | Since Incept. |
|---|---|---|---|
| Int'l. Stocks | **4.0%** | **34.3%** | **22.8%** |
| EAFE | 0.9 | 32.6 | 21.4 |

### Domestic Bonds

The domestic bond manager group (active and semi-passive combined) exceeded its target for the quarter and year.

| | Qtr. | 1 Yr. | 3 Yr. | 5 Yr. |
|---|---|---|---|---|
| Bonds | **0.1%** | **11.5%** | **12.0%** | **11.7%** |
| Salomon BIG | 0.0 | 9.9 | 11.1 | 11.3 |

Note: The above returns reflect the performance of the Basic Funds' managers through 6/30/93 and of the Combined Funds (Basic and Post) since 7/1/93.

**Wilshire 5000:** The Wilshire 5000 stock index reflects the performance of all publicly traded stocks of companies domiciled in the U.S.

**EAFE:** The Morgan Stanley Capital International index of 18 stock markets in Europe, Australia and the Far East.

**Salomon BIG:** The Salomon Broad Investment Grade bond index reflects the performance of all investment grade (BAA or higher) bonds, U.S. treasury and agency securities and mortgage obligations with maturities greater than one year.

# STOCK AND BOND MANAGERS

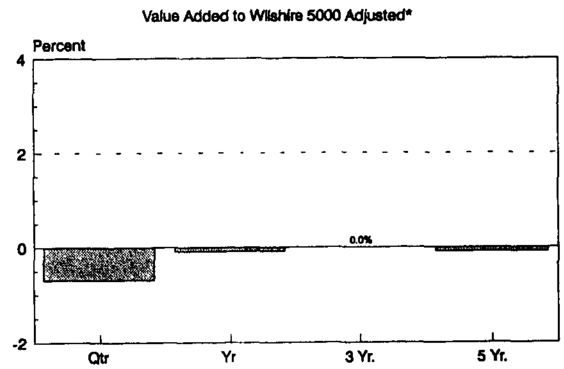
## Performance of Asset Pools

### Domestic Stock Pool

Target: Wilshire 5000 Adjusted*
**Expectation:** If half of the pool is actively managed and half is passively managed, the entire pool is expected to exceed the target by +.20-.45% annualized, over time.

| | Qtr. | Yr. | Annualized 3 Yrs. | Annualized 5 Yrs. |
|---|---|---|---|---|
| **Stock Pool** | **1.4%** | **10.9%** | **17.5%** | **14.1%** |
| Wilshire 5000* | 2.1 | 11.0 | 17.5 | 14.2 |

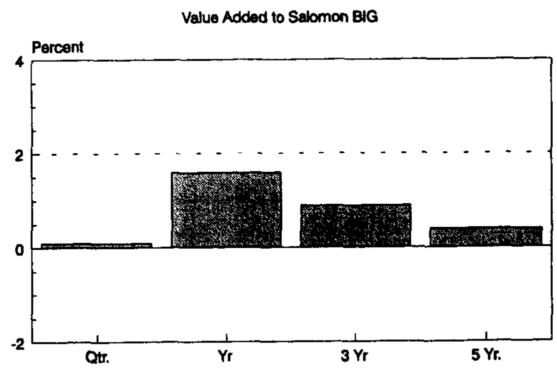
*Buy/hold index adjusted for liquor and tobacco restrictions through 3/31/93 and AHP restriction through 10/31/93.




### Domestic Bond Pool

**Target:** Salomon Broad Investment Grade (BIG) Index
**Expectation:** If half of the pool is actively managed and half is managed semi-passively, the entire pool is expected to exceed the target by +.20-.35% annualized, over time.

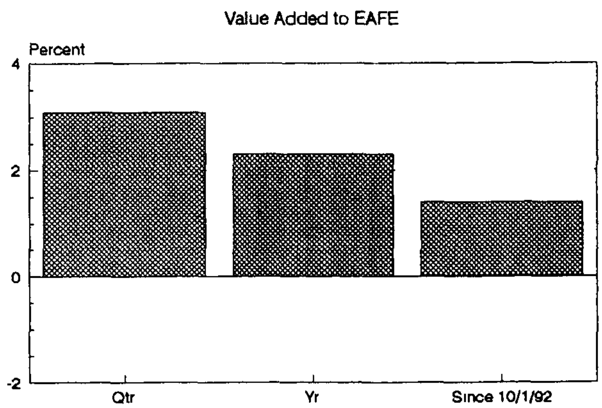
| | Qtr. | Yr. | Annualized 3 Yrs. | Annualized 5 Yrs. |
|---|---|---|---|---|
| **Bond Pool** | **0.1%** | **11.5%** | **12.0%** | **11.7%** |
| Salomon BIG | 0.0 | 9.9 | 11.1 | 11.3 |




### International Stock Pool

**Target:** EAFE
**Expectation:** If half of the pool is managed actively, the entire pool is expected to exceed the target by +.25-.75% annualized, over time.

| | Qtr. | Yr. | Since 10/1/92 |
|---|---|---|---|
| **Int'l. Pool** | **4.0%** | **34.3%** | **22.8%** |
| EAFE | 0.9 | 32.6 | 21.4 |



## INTERNATIONAL STOCK MANAGERS
## PERIOD ENDING 12/31/93

| Current Managers | Quarter Actual | Quarter Bmk | 1 Year Actual | 1 Year Bmk | Since Inception Actual | Since Inception Bmk | % of Pool | Mkt Value (millions) |
|---|---|---|---|---|---|---|---|---|
| Baring(1) | 13.6% | 0.9% | -- | -- | 27.2% | 18.4% | 9.7% | $184.0 |
| Brinson(1) | 2.8 | 0.9 | -- | -- | 10.4 | 18.4 | 8.6 | 161.8 |
| Marathon(2) | -0.3* | -2.2* | -- | -- | -0.3 | -2.2 | 7.9 | 149.5 |
| Rowe Price(2) | 7.5* | -2.2* | -- | -- | 7.5 | -2.2 | 8.5 | 161.2 |
| Scudder(2) | 4.9* | -2.2* | -- | -- | 4.9 | -2.2 | 8.5 | 160.7 |
| Templeton | 1.6* | -2.2* | -- | -- | 1.6 | -2.2 | 8.2 | 155.4 |
| State Street(3) | 0.9 | 0.9 | 32.3 | 32.6 | 21.4 | 21.4 | 48.6 | 918.7 |
| **Current Aggregate** | **4.0** | **0.9** | **34.3** | **32.6** | **22.8** | **21.4** | **100.0%** | **$1,891.3** |

(1) Active country/passive stock. Retained April 1, 1993
(2) Fully active. Retained November 1, 1993
(3) Index. Retained October 1, 1992

* November-December only

**AGENDA**
**INVESTMENT ADVISORY COUNCIL**
**MEETING**
**Tuesday, June 7, 1994**
**2:00 P.M. - SBI Conference Room**
**Room 105, MEA Building - Saint Paul**

| | TAB |
|---|---|
| **1. Approval of Minutes of March 1, 1994** | |
| **2. Report from the Executive Director (H. Bicker)** | |
| A. Quarterly Investment Review (December 31, 1993 - March 31, 1994) | A |
| B. Portfolio Statistics (March 31, 1994) | B |
| C. Administrative Report | C |
| 1. Budget report | |
| 2. Travel report | |
| 3. Update on 1994 Legislative Session | |
| 4. SBI/IAC meeting schedule for remainder of calendar 1994 | |
| 5. Issues to be referred to the Deferred Compensation Review Committee | |
| **3. Election of IAC Chair and Vice Chair** | |
| **4. Reports from the Investment Advisory Council** | |
| **A. Stock and Bond Manager Committee (J. Eckmann)** | D |
| 1. Review of manager performance for period ending 3/31/94 | |
| 2. Update on candidates for Manager Monitoring Program | |
| 3. Annual review of investment manager guidelines | |
| 4. Report from the Passive Manager Review Committee | |
| 5. Recommendation to use the Lehman Aggregate | |
| 6. Recommendation concerning the management structure of the Assigned Risk Plan | |
| **B. Alternative Investment Committee (D. Veverka)** | E |
| 1. Results of annual review sessions | |
| 2. Commitment to a new real estate manager (CB Commercial) | |
| 3. Commitment to a new private equity manager (Hellman & Friedman) | |
| **5. Report from the SBI Administrative Committee** | F |
| 1. Approval of Executive Director's Work Plan for FY95 | |
| 2. Approval of Budget Plan for FY95 | |
| 3. Approval of Continuing Fiduciary Education Plan | |
| 4. Approval of process for Executive Director's FY94 evaluation | |
| 5. Approval of preliminary FY96-97 biennial budget request | |
| 6. Authorization of contract amendment with State Street Bank | |
| 7. Approval of monitoring process for International Investing Guidelines | |
| 8. Consideration of re-negotiated contracts for the Deferred Compensation Plan | |

# Minutes
# Investment Advisory Council
# March 1, 1994

**MEMBERS PRESENT:** Gary Austin; Dave Bergstrom; Ken Gudorf; Laurie Fiori Hacking; Keith Johnson; Peter Kiedrowski; Han Chin Liu; Malcolm McDonald; Gary Norstrem; Barbara Schnoor; Mike Troutman and Debbie Veverka.

**MEMBERS ABSENT:** John Bohan; Jim Eckmann; John Gunyou; David Jeffery and Jan Yeomans.

**SBI STAFF:** Howard Bicker; Beth Lehman; Jim Heidelberg; Dan Egeland; Karen Vnuk; Debbie Griebenow; Charlene Olson and Linda Nadeau.

**OTHERS ATTENDING:** Ann Posey, Richards & Tierney; John Wicklund, Teachers Retirement Association; Christie Eller; Peter Sausen; Elaine Voss; Ed Stuart; Mike Ousdigian; and Robert Whitaker.

Mr. McDonald called the meeting to order and the members agreed to change the order of the agenda.

**Alternative Investment Committee Report**
Ms. Veverka referred members to Tab F of the meeting materials and compared the actual alternative investment allocations to the targeted allocations for the Basic and the Post Funds. She reported the results of an annual review with an existing private equity manager, Churchill Capital. She stated that although four staff members of the firm had departed recently, everything appeared in order and that the firm is in the process of hiring replacements and that the meeting produced no major surprises. She reported that the Committee is recommending commitments to three managers: TA Associates Realty, the Coral Group (formerly IAI Venture Capital Group) and Summit Partners. She described each fund, noting that the investment with Summit Partners is the first alternative investment recommended for the Post Retirement Fund and that the other two investments are being recommended for the Basic Funds. She stated that the Summit investment is structured so that the Post Fund will receive a relatively quick turnaround on its capital. In response to a question from Mr. McDonald, Ms. Veverka stated that the return on the Summit investment is expected to be around 15-18%. Mr. Gudorf moved approval of all three of the Committee's recommendations as stated in the Committee Report. Ms. Schnoor seconded the motion. The motion passed.

**Administrative Committee Report**
Mr. Bicker referred members to Tab G of the meeting materials and noted that there were two informational items on which to update members.

Mr. Bicker updated members on the police and fire pension fund activity. He explained that in 1987 legislation was passed which allows salaried local police and fire funds to merge with the Public Employees Retirement Association (PERA) and that since that time, 32 of the 47 plans eligible to merge with PERA have done so. He stated that 3 plans are in the process of merging and that 12 plans have elected not to merge as yet. He noted that the Minneapolis Police and Minneapolis Fire plans are two plans of significant size that have chosen not to merge as yet. Mr. Bicker explained that there has also been a great deal of activity among the volunteer firefighter relief associations to utilize the Supplemental Investment Fund (SIF) as an investment option for all or a portion of their assets. He reported that there are currently 66 plans participating in the SIF and that staff expects that number to continue to increase. He noted that Auditor Dayton is responsible for auditing these firefighter plans and that he is examining their pension operations more closely. Mr. Bicker noted the additional work flow for staff associated with the mergers and additional participation in the Supplemental Investment Fund. In response to a question from Mr. Norstrem, Mr. Bicker clarified that most of the funds that were listed as funds withdrawing from the SIF were a result of consolidations with PERA, so in effect they were just fund transfers from the SIF to the Basic and Post Funds.

Mr. Bicker reviewed the history of the Deferred Compensation Plan, noting the significant growth the Plan has had since outside vendors were added in 1980. He said that at its December 1993 meeting, the SBI urged Mr. Bicker and Mr. Bergstrom to proceed with contract renegotiations with the insurance companies and the marketing organizations. Mr. Bicker referred members to the meeting materials for a comparison of the current and proposed contract terms. He explained each of the proposed terms and discussed the impact and benefits of the proposed changes. He also stated that Minnesota Mutual has agreed to increase the portability on their fixed products to 20% which was not reflected in the meeting materials. Mr. Bicker discussed the impact of rebidding the contracts, which, in his opinion, would adversely affect the individual participants. He stated that the letters of intent are not legally binding but that they do provide a framework within which a contract could be written if the Board chooses to proceed with the contract renegotiations. Mr. Bicker said that he and Mr. Bergstrom will recommend to the Board to continue the renegotiation process because they believe renegotiation to be in the best interest of the participants. He added that the consultant from the Wyatt Company would also be present at the Board meeting and that she concurs with the recommendation to continue the renegotiation process.

In response to a question from Mr. Troutman, Mr. Bicker explained the different exit provisions currently available through the two insurance companies and he said that exit provisions and vested commissions are two important areas that are being addressed in the renegotiation process. He also explained some areas of potential litigation that could be avoided through renegotiation and he added that any legal costs would have to be paid by the Plan. In response to questions from Mr. Gudorf, Mr. Bicker said these are no penalities assessed due to the renegotiation process itself, the only direct cost associated with the renegotiation process are the costs for the consultant which are billed back to the insurance companies. In response to a question from Mr. Norstrem, Mr. Bicker confirmed that, currently, the marketing contracts are with the insurance companies and he explained that under the proposed terms the marketer's contracts would be with MSRS and approved by the SBI. He stressed that this would help transition the process from a marketing focus to that of informing, educating and servicing all participants in the Plan. Mr. Bergstrom added that the compensation will be equal for all products, thus eliminating any incentive to sell one product over another. In response to a question from Mr. Norstrem, Mr. Bergstrom stated that under the letters of intent, the existing contracts between the marketing organizations and the insurance companies will be severed and that both the marketing companies and the insurance companies will have contracts directly with MSRS.

In response to a question from Mr. Liu, Mr. Bergstrom stated under the proposed compensation formula, the compensation paid to the marketing firms would decrease over time from 33 basis points down to 28 basis points and that these figures are in line with what MSRS's consultant recommended and with the national average for similar plans. In response to a question from Mr. McDonald, Mr. Bicker confirmed that this is not an action item for the IAC and that he would make his report directly to the Board.

**Approval of the Minutes**
Mr. Johnson moved to accept the minutes of the December 14, 1993 meeting. Mr. McDonald seconded the motion. The motion passed.

**Executive Director's Report**
Mr. Bicker referred members to Tab A of the meeting materials and reported that the Combined Funds, Basic Funds and Post Fund had all outperformed their respective return objectives for the period. In response to a question from Mr. Gudorf, Mr. Bicker reminded members that the Post Fund return figure is only from 7/1/93 forward which is the date when the asset allocation transition was completed. He stated that the Basic Funds are now over $10 billion in size and that the Basics' asset mix is on target with its long-term policy. He said that the Basic Funds had underperformed for the quarter (Basics 1.2% vs. Composite 1.6%) but had outperformed for the year (Basics 12.2% vs. Composite 12.0%), and five year period (Basics 12.8% vs. Composite 12.1%). Mr. Bicker reported that the Post Retirement Fund was just under $9 billion as of December 31, 1993. He stated that the Post Fund's allocation to international stocks was fully funded during the quarter. He reported that the total fund has matched its composite index (1.4%) for the quarter and exceeded it since 7/1/93 (Post Fund 5.0% vs. Composite 4.6%).

Mr. Bicker briefly reviewed the stock manager performance and said that further discussion would follow during the Stock and Bond Committee Report. He distributed a handout (see **Attachment A**) and stated that it included a revised performance figure for the international stock component since inception. He stated that the international component had actually outperformed its target since inception (Int'l. Stocks 22.8% vs. EAFE 21.4%) and not underperformed as stated in the meeting materials. Mr. Bicker stated that the domestic bond manager group had outperformed for both the quarter (Domestic Bonds 0.1% vs. Salomon BIG 0.0%) and year (Domestic 11.5% vs. Salomon BIG 9.9%). Mr. Bicker reported that the Assigned Risk Plan (ARP) had underperformed its composite index for the quarter (ARP 1.1% vs. Composite 1.3%) but outperformed it for the year (ARP 7.1% vs. Composite 6.4%). Mr. Bicker stated that staff has some concerns regarding the equity portion of the ARP which would also be discussed in more detail during the Stock and Bond Manager Committee Report. He said that as of December 31, 1993 the SBI was responsible for $22.9 billion in assets.

**Executive Director's Administrative Report**

Mr. Bicker referred members to Tab C of the meeting materials for updates on the budget and travel. He said his recommendation concerning the review of vendors for the retirement plans administered by the State University and Community College Systems had been revised from what was included in the meeting materials. He said that staff is recommending a one year extension to the contract with the current vendors in order for the rebidding of the contracts to coincide with the merger of the State University System, Community College System and Technical Colleges Boards which will take place on July 1, 1995. Mr. Bergstrom moved approval of the recommendation, as stated by Mr. Bicker. Mr. Kiedrowski seconded the motion. The motion passed.

**Asset Allocation Committee Report**

Due to the absence of several members of the Asset Allocation Committee, Mr. Bicker gave the Committee report. Mr. Bicker provided members with some background information on the management structure of the Assigned Risk Plan (ARP) and he stated that currently the asset allocation of the Plan is 80% bonds and 20% stocks. He said that the ARP has a single manager, Voyageur Asset Management, who actively manages both the stock and bond segments of the ARP. He explained that staff originally believed Voyageur's investment approach would be fairly representative of the broad market, but that experience over the last 2.5 years had shown otherwise which resulted in the Plan being exposed to inappropriate levels of active risk. Mr. Bicker said that staff had recommended that the stock segment of the ARP be managed by SBI staff as part of an internally managed index pool that is designed to track the S&P 500. He reported that the Committee would like additional time to consider the proposal before making a recommendation to the SBI/IAC. He added that the Committee is not opposed to the passive management approach suggested by staff, but that they believe other management structures may be applicable as well. He said that Voyageur supports the idea of indexing the equity segment. He noted that the Assigned Risk Plan's equities cannot be merged with other equity portfolios since the ARP is a taxable entity while all other equities invested by the SBI are in tax-exempt funds. In response to a question from Mr. Troutman, Mr. Bicker stated that the ARP's assets are not large enough to track an extended index such as the Wilshire 5000 so staff felt that the S&P 500 was the most appropriate index to track.

Mr. Bicker reported that the Committee had also approved and is recommended the adoption of the position paper for the Post Retirement Fund. He noted that it summarizes the history of the Post Fund, reviews the impact of the old and new benefit increase formulas and discusses the rationale for the old and new asset allocation policies for the Fund. Ms. Veverka stated that she believes the paper should reflect the impact that a period of poor returns could have on the funded status of the plan. Mr. Bicker clarified that the investment based component of the benefit increase will not be paid until any unfunded liabilities due to any inflation based increases that had already been granted. Ms. Veverka amended the Committee's recommendation to include the information she suggested when the paper is updated in the future. Mr. McDonald then moved approval of the amended recommendation. Ms. Veverka seconded the motion. The motion passed.

**Stock and Bond Manager Committee Report**

Mr. Troutman referred members to Tab E of the meeting materials and discussed staff and the Committee's concerns with the level of negative tracking error being experienced by the SBI's passive equity manager, Wilshire Asset Management. He stated that staff had suggested to the Committee that the SBI conduct a passive manager search and consider the Russell 3000 as a potential replacement for the Wilshire 5000 as the SBI's asset class target for domestic stocks. He explained the differences in the two indexes and noted that two additional candidates, Bankers Trust and Wells Fargo would be included in the passive manager search. He reported that the Committee's recommendation is that the SBI establish a Passive Manager Review Committee to consider which combination of passive manager and asset class target can be implemented most efficiently and effectively. In response to a question from Ms. Veverka, Mr. Troutman stated that the manager candidates would be evaluated on their capability to manage the passive portfolio as a completion fund for the total equity program. In response to questions from Mr. Gudorf, Mr. Bicker said that the size of the index fund currently is $5 billion and that the Review Committee will examine the capability of managers to handle accounts of this size given their existing staff and history of staff turnover. He added that staff believe it may be more efficient to continue having only one passive manager despite the large size of the portfolio. Mr. Troutman agreed and stated his belief that the evaluation criteria must include evaluation of a firm's capabilities to manage a large portfolio. In response to questions from Mr. Gudorf, Mr. Troutman and Mr. Bicker stated that both staff and Richards & Tierney are in the process of completing some analysis to explain Wilshire's recent underperformance more completely. In response to a question from Ms. Hacking, Mr. Bicker stated that he felt ± 30-50 basis points would be an acceptable tracking error range. He noted that some of the tracking error should occasionally be on the positive side and he added that Wilshire's tracking error has been consistently negative. Mr. Troutman noted that over a 10 year time period it would be reasonable to expect the tracking error to be ± 5-10 basis points. In response to an observation by Ms. Veverka, Mr. Bicker agreed that some of Wilshire's underperformance could have been the result of using Wilshire as a transition manager to fund various new managers. However, he added that staff believes it is important to conduct a thorough review given the size of the assets under management. In response to questions from Ms. Veverka and Mr. McDonald, Mr.

Bicker explained that the new manager candidates will be asked to create and evaluate paper portfolios using the same historical benchmarks against which Wilshire was measured. In conclusion, Mr. Troutman stated that the Review Committee will make its report back to the Stock and Bond Committee in time for a recommendation to be made at the June 1994 Board/IAC meetings. Mr. McDonald asked Mr. Troutman to present the remainder of the Committee's report before taking action on the above recommendation.

Mr. Troutman reported that the Committee had discussed a proposal from staff to add a semi-passive management component to the domestic stock program. He stated that the Committee expects to make a recommendation on the proposal after further analysis and after addressing the current passive management issues discussed above. In response to a question from Mr. McDonald, Mr. Troutman stated that the Committee will focus on what types of semi-passive managers are available and what the risk/rewards of this strategy might be and its impact on the overall profile of the domestic equity program. Mr. Bicker added that staff is collecting additional information to insure that there are enough experienced and qualified firms to potentially handle semi-passive portfolios of $500-750 million for the SBI.

Mr. Troutman then asked if he could express his comments on a related issue. He stated that the volatility of a manager's return is usually a focus at the IAC/SBI meetings each quarter and he restated his belief that the SBI sometimes moves too quickly to terminate managers who have underperformed over short time periods. He stated that a former manager for the SBI who was terminated due to a lagging performance over a relatively short time period, Rosenberg Institutional, had recently performed very well, adding over 400 basis points to their benchmark for 1993. He observed that it will require a number of years to know whether the SBI's decision to terminate Rosenberg was good or bad. He stressed the importance of evaluating a manager's long-term capabilities and rather than focusing on difficult periods of poor short-term performance. Mr. Johnson agreed.

Mr. Troutman moved approval of the Committee's recommendation to establish a Passive Manager Review Committee to evaluate the manager candidates as well as the asset class target for the domestic equity program, as stated in the Committee Report. Mr. Bergstrom seconded the motion. The motion passed.

The meeting adjourned at 3:25 P.M.

Respectfully submitted,

Howard J. Bicker

Howard J. Bicker
Executive Director

# EXECUTIVE SUMMARY
## Stock and Bond Manager Performance

### Domestic Stocks

The domestic stock manager group (active and passive combined) trailed its target for the quarter and year.

| | Qtr. | 1 Yr. | 3 Yr. | 5 Yr. |
|---|---|---|---|---|
| Dom. Stocks | **1.4%** | **10.9%** | **17.5%** | **14.1%** |
| Wilshire 5000* | 2.1 | 11.0 | 17.5 | 14.2 |

* Buy/hold index adjusted for liquor and tobacco restrictions through 3/31/93 and AHP restriction through 10/31/93.

### International Stocks

The international stock manager group (active and passive combined) exceeded its target for the quarter and year.

| | Qtr. | 1 Yr. | Since Incept. |
|---|---|---|---|
| Int'l. Stocks | **4.0%** | **34.3%** | **22.8%** |
| EAFE | 0.9 | 32.6 | 21.4 |

### Domestic Bonds

The domestic bond manager group (active and semi-passive combined) exceeded its target for the quarter and year.

| | Qtr. | 1 Yr. | 3 Yr. | 5 Yr. |
|---|---|---|---|---|
| Bonds | **0.1%** | **11.5%** | **12.0%** | **11.7%** |
| Salomon BIG | 0.0 | 9.9 | 11.1 | 11.3 |

Note: The above returns reflect the performance of the Basic Funds' managers through 6/30/93 and of the Combined Funds (Basic and Post) since 7/1/93.

**Wilshire 5000:** The Wilshire 5000 stock index reflects the performance of all publicly traded stocks of companies domiciled in the U.S.

**EAFE:** The Morgan Stanley Capital International index of 18 stock markets in Europe, Australia and the Far East.

**Salomon BIG:** The Salomon Broad Investment Grade bond index reflects the performance of all investment grade (BAA or higher) bonds, U.S. treasury and agency securities and mortgage obligations with maturities greater than one year.

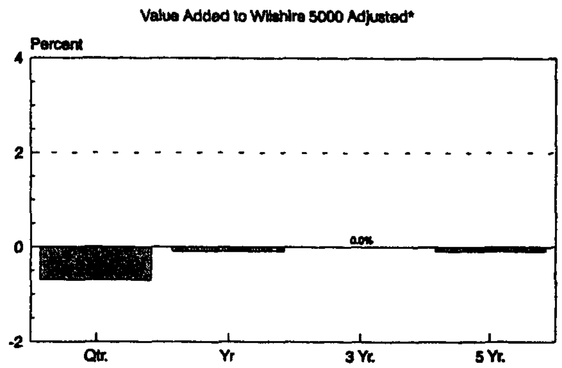
# STOCK AND BOND MANAGERS
## Performance of Asset Pools

### Domestic Stock Pool

Target: Wilshire 5000 Adjusted*
**Expectation:** If half of the pool is actively managed and half is passively managed, the entire pool is expected to exceed the target by +.20-.45% annualized, over time.

| | Qtr. | Yr. | Annualized 3 Yrs. | Annualized 5 Yrs. |
|---|---|---|---|---|
| **Stock Pool** | **1.4%** | **10.9%** | **17.5%** | **14.1%** |
| Wilshire 5000* | 2.1 | 11.0 | 17.5 | 14.2 |

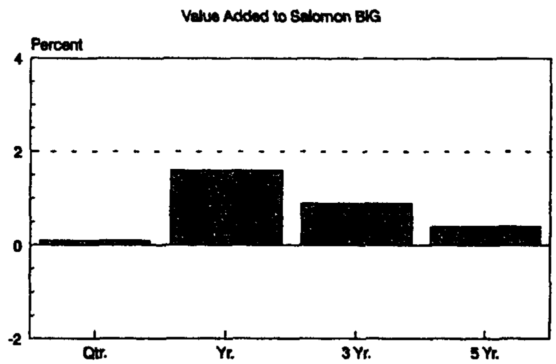
*Buy/hold index adjusted for liquor and tobacco restrictions through 3/31/93 and AHP restriction through 10/31/93.




### Domestic Bond Pool

**Target:** Salomon Broad Investment Grade (BIG) Index
**Expectation:** If half of the pool is actively managed and half is managed semi-passively, the entire pool is expected to exceed the target by +.20-.35% annualized, over time.

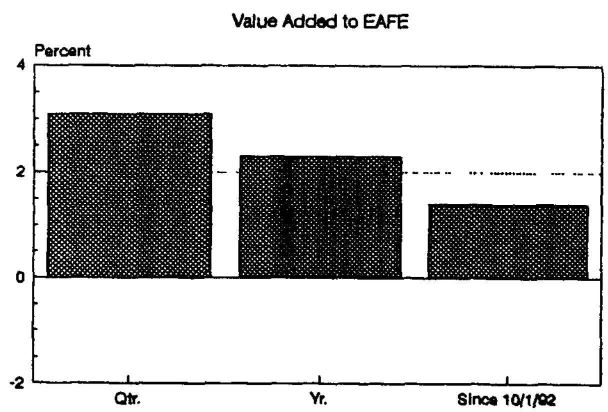
| | Qtr. | Yr. | Annualized 3 Yrs. | Annualized 5 Yrs. |
|---|---|---|---|---|
| **Bond Pool** | **0.1%** | **11.5%** | **12.0%** | **11.7%** |
| Salomon BIG | 0.0 | 9.9 | 11.1 | 11.3 |




### International Stock Pool

**Target:** EAFE
**Expectation:** If half of the pool is managed actively, the entire pool is expected to exceed the target by +.25-.75% annualized, over time.

| | Qtr. | Yr. | Since 10/1/92 |
|---|---|---|---|
| **Int'l. Pool** | **4.0%** | **34.3%** | **22.8%** |
| EAFE | 0.9 | 32.6 | 21.4 |



# INTERNATIONAL STOCK MANAGERS
# PERIOD ENDING 12/31/93

| Current Managers | Quarter Actual | Quarter Bmk | 1 Year Actual | 1 Year Bmk | Since Inception Actual | Since Inception Bmk | % of Pool | Mkt Value (millions) |
|---|---|---|---|---|---|---|---|---|
| Baring(1) | 13.6% | 0.9% | -- | -- | 27.2% | 18.4% | 9.7% | $184.0 |
| Brinson(1) | 2.8 | 0.9 | -- | -- | 10.4 | 18.4 | 8.6 | 161.8 |
| Marathon(2) | -0.3* | -2.2* | -- | -- | -0.3 | -2.2 | 7.9 | 149.5 |
| Rowe Price(2) | 7.5* | -2.2* | -- | -- | 7.5 | -2.2 | 8.5 | 161.2 |
| Scudder(2) | 4.9* | -2.2* | -- | -- | 4.9 | -2.2 | 8.5 | 160.7 |
| Templeton | 1.6* | -2.2* | -- | -- | 1.6 | -2.2 | 8.2 | 155.4 |
| State Street(3) | 0.9 | 0.9 | 32.3 | 32.6 | 21.4 | 21.4 | 48.6 | 918.7 |
| **Current Aggregate** | **4.0** | **0.9** | **34.3** | **32.6** | **22.8** | **21.4** | **100.0%** | **$1,891.3** |

(1) Active country/passive stock. Retained April 1, 1993
(2) Fully active. Retained November 1, 1993
(3) Index. Retained October 1, 1992

* November-December only

# Tab A

# RETURN OBJECTIVES
## Period Ending 3/31/94

| COMBINED FUNDS: $18.4 Billion | Return | Compared to Objective |
|---|---|---|
| **Provide Real Return (10 yr.)**<br><br>Provide returns that are 3-5 percentage points greater than inflation over moving 10 year periods. | 12.7% (1) | 8.9 percentage points above target |
| **Exceed Median Fund (5 yr.)**<br><br>Outperform the median fund from a universe of public and corporate funds with a balanced asset mix over moving 5 year periods. | 11.2% (1) | 0.2 percentage points above target<br>Rank: 44th percentile (2) |
| **Exceed Composite Index (5 yr.)**<br><br>Outperform a composite market index weighted in a manner that reflects the actual asset mix of the Combined Funds over moving 5 year periods. | 11.2% (1) | 0.6 percentage points above target |

| BASIC RETIREMENT FUNDS: $9.7 Billion | Return | Compared to Objective |
|---|---|---|
| **Exceed Composite Index (5 Yr.)**<br><br>Outperform a composite index weighted in a manner that reflects the long-term asset allocation of the Basic Funds over moving 5 year periods. | 11.2% | 0.5 percentage points above target |

| POST RETIREMENT FUND: $8.7 Billion | Return | Compared to Objective |
|---|---|---|
| **Exceed Composite Index**<br><br>Outperform a composite index weighted in a manner that reflects the long-term asset allocation of the Post Fund over moving 5 year periods. | 2.2% (3) | 0.3 percentage points above target (3) |

(1) Reflects performance of Basic Funds only through 6/30/93, Combined Funds thereafter.

(2) The SBI's stated performance objective is to rank in the top half (above 50th percentile) of the comparative universe. The SBI will strive to achieve performance which ranks in the top third (above 33rd percentile).

(3) Since asset allocation transition was completed, 7/1/93.

# ACTUARIAL VALUATIONS

## MSRS, TRA, PERA General Plans
## June 30, 1993

| | Active (Basics) | Retired (Post) | Total (Basics & Post) |
|---|---|---|---|
| **Liability Measures** | | | |
| 1. Current and Future Benefit Obligation | $15.8 billion | $6.4 billion | $22.2 billion |
| 2. Accrued Liabilities | 11.2 | 6.4 | 17.6 |
| **Asset Measures** | | | |
| 3. Current and Future Actuarial Value | $15.2 billion | $6.4 billion | $21.6 billion |
| 4. Current Actuarial Value | 7.9 | 6.4 | 14.3 |
| **Funding Ratios** | | | |
| Future Obligations vs. Future Assets (3 ÷ 1) | 96% | 100% | 97% |
| Accrued Liabilities vs. Current Actuarial Value (4 ÷ 2) | 71% | 100% | 81%* |

* Ratio most frequently used by the Legislature and Retirement Systems.

The funding ratio required by **Governmental Standard Accounting Board Statement No. 5** compares Cost Value of assets to the Current Benefit Obligation. This calculation provides funded ratios of **78%** for the Basics, **100%** for the Post and **86%** for the Total, respectively.

**Notes:**
1. Present value of projected benefits that will be due to all current participants.
2. Liabilities attributed to past service calculated using entry age normal cost method.
3. Present value of future statutory contributions plus current actuarial value.
4. Same as required reserves for Post. Cost plus one-third of the difference between cost and market value for Basics.

**Actuarial Assumptions:**

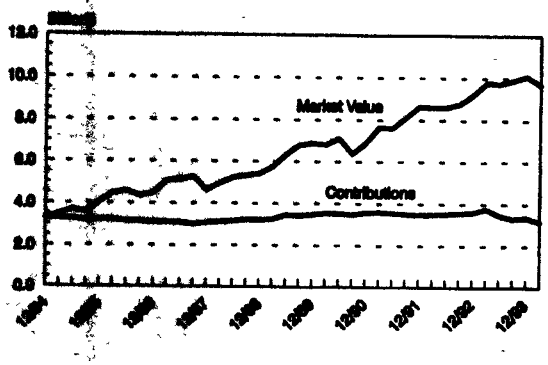
Salary Growth: 6.5%
Interest//Discount Rate: 8.5% Basics, 5.0% Post
Full Funding Target Date: 2020

# EXECUTIVE SUMMARY
## Basic Retirement Funds

### Asset Growth

The market value of the Basic Funds decreased 3.9% during the first quarter of 1994. Negative investment returns and net withdrawals accounted for the decrease during the period.

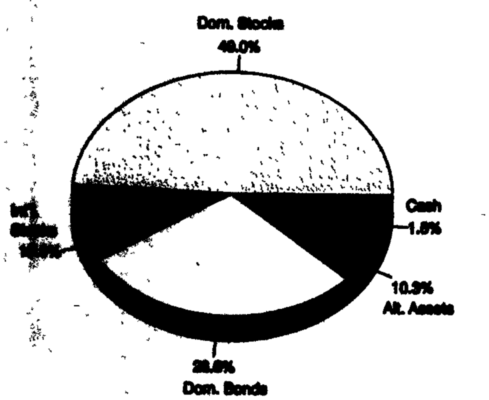
| | Asset Growth During First Quarter 1994 (Millions) |
|---|---|
| Beginning Value | $10,086 |
| Net Contributions | -187 |
| Investment Return | -202 |
| Ending Value | $9,697 |




### Asset Mix

Domestic stocks are slightly under the policy target while cash is slightly over. Bonds will exceed their target until alternative assets increase.

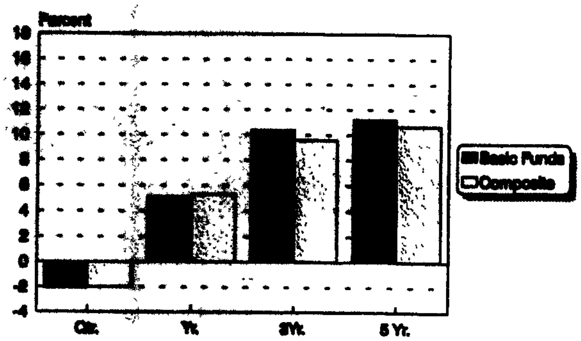
| | Policy Asset Mix | Actual Mix 3/31/94 | Actual Market Value (Millions) |
|---|---|---|---|
| Domestic Stocks | 50.0% | 49.0% | $4,750 |
| Int'l. Stocks | 10.0 | 10.3 | 996 |
| Bonds | 24.0 | 28.6 | 2,772 |
| Alternative Assets | 15.0 | 10.3 | 1,003 |
| Unallocated Cash | 1.0 | 1.8 | 176 |
| | 100.0% | 100.0% | $9,697 |




### Fund Performance

The Basic Funds trailed its composite market index for the quarter and for the year.

| | Qtr. | 1 Yr. | 3 Yr. | 5 Yr. |
|---|---|---|---|---|
| Basics | -2.1% | 5.1% | 10.4% | 11.2% |
| Composite | -2.0 | 5.3 | 9.6 | 10.7 |



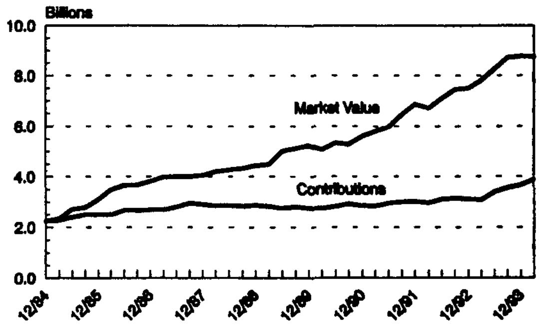
# EXECUTIVE SUMMARY

## Post Retirement Fund

### Asset Growth

The market value of the Post Fund decreased 0.3% during the first quarter of 1994. The decrease resulted from negative investment returns.

| | Asset Growth During First Quarter 1994 (Millions) |
|---|---|
| Beginning Value | $8,766 |
| Net Contributions | 211 |
| Investment Return | -235 |
| Ending Value | $8,742 |

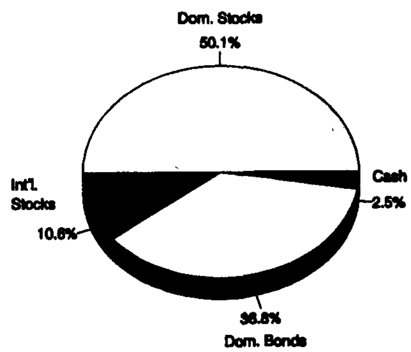



### Asset Mix

The asset mix is in line with policy targets. Domestic bonds will exceed its target until alternative assets increase.

| | Policy Asset Mix | Actual Mix 3/31/94 | Actual Market Value (Millions) |
|---|---|---|---|
| Domestic Stocks | 50.0% | 50.1% | $4,377 |
| Int'l. Stocks | 10.0 | 10.6 | 925 |
| Domestic Bonds | 32.0 | 36.8 | 3,221 |
| Alternative Assets | 5.0 | 0.0* | 2 |
| Unallocated Cash | 3.0 | 2.5 | 217 |
| | 100.0% | 100.0% | $8,742 |

* less than 0.1%

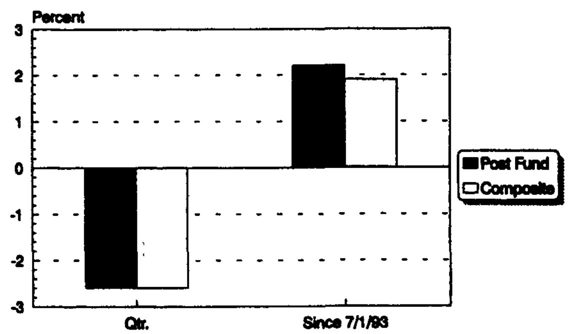



### Fund Performance

The Post Fund matched its composite market index for the quarter and exceeded the composite since 7/1/93.

| | Qtr. | Since 7/1/93* |
|---|---|---|
| **Post Fund** | **-2.6%** | **2.2%** |
| Composite | -2.6 | 1.9 |

* Date asset allocation transition to 50% domestic common stocks was completed.



# EXECUTIVE SUMMARY
## Stock and Bond Manager Performance

### Domestic Stocks

The domestic stock manager group (active and passive combined) exceeded its target for the quarter and met its target for the year.

| | Qtr. | 1 Yr. | 3 Yr. | 5 Yr. |
|---|---|---|---|---|
| Dom. Stocks | -3.5% | 2.5% | 10.3% | 11.6% |
| Wilshire 5000* | -3.8 | 2.5 | 10.3 | 11.8 |

* Buy/hold index adjusted for liquor and tobacco restrictions through 3/31/93 and AHP restriction through 10/31/93.

### International Stocks

The international stock manager group (active and passive combined) trailed its target for the quarter and year.

| | Qtr. | 1 Yr. | Since Incept.* |
|---|---|---|---|
| Int'l. Stocks | 1.6% | 22.0% | 19.9% |
| EAFE | 3.5 | 22.5 | 20.3 |

* since 10/1/92

### Domestic Bonds

The domestic bond manager group (active and semi-passive combined) met its target for the quarter and exceeded its target for the year.

| | Qtr. | 1 Yr. | 3 Yr. | 5 Yr. |
|---|---|---|---|---|
| Bonds | -2.8% | 3.6% | 9.9% | 10.8% |
| Salomon BIG | -2.8 | 2.6 | 9.1 | 10.5 |

Note: The above returns reflect the performance of the Basic Funds' managers through 6/30/93 and of the Combined Funds (Basic and Post) since 7/1/93.

Wilshire 5000: The Wilshire 5000 stock index reflects the performance of all publicly traded stocks of companies domiciled in the U.S.

EAFE: The Morgan Stanley Capital International index of 20 stock markets in Europe, Australia and the Far East.

Salomon BIG: The Salomon Broad Investment Grade bond index reflects the performance of all investment grade (BAA or higher) bonds, U.S. treasury and agency securities and mortgage obligations with maturities greater than one year.

## EXECUTIVE SUMMARY
### Assigned Risk Plan

**Investment Objective**
The Assigned Risk Plan has two investment objectives: to minimize the mismatch between assets and liabilities and to provide sufficient liquidity for the payment of on-going claims and operating expenses.

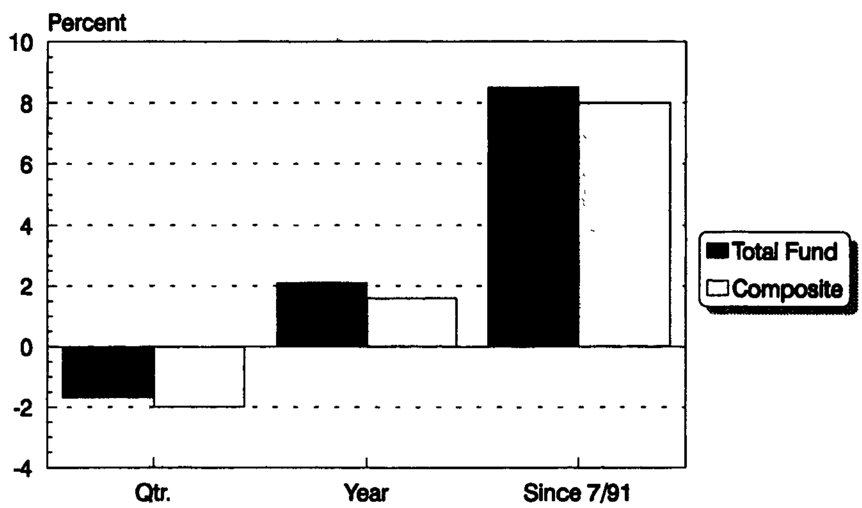
**Asset Mix**
The Assigned Risk Plan is invested in a balanced portfolio of common stocks and bonds. The actual asset mix will fluctuate in response to changes in the Plan's liability stream.

| | 3/31/94 Target | 3/31/94 Actual |
|---|---|---|
| Stocks | 20.0% | 17.8% |
| Bonds | 80.0 | 78.4 |
| Unallocated Cash | 0.0 | 3.8 |
| Total | 100.0% | 100.0% |

**Investment Management**
The entire fund is managed externally by Voyageur Asset Management. The portfolio was transferred from the Department of Commerce to the SBI on May 1, 1991.

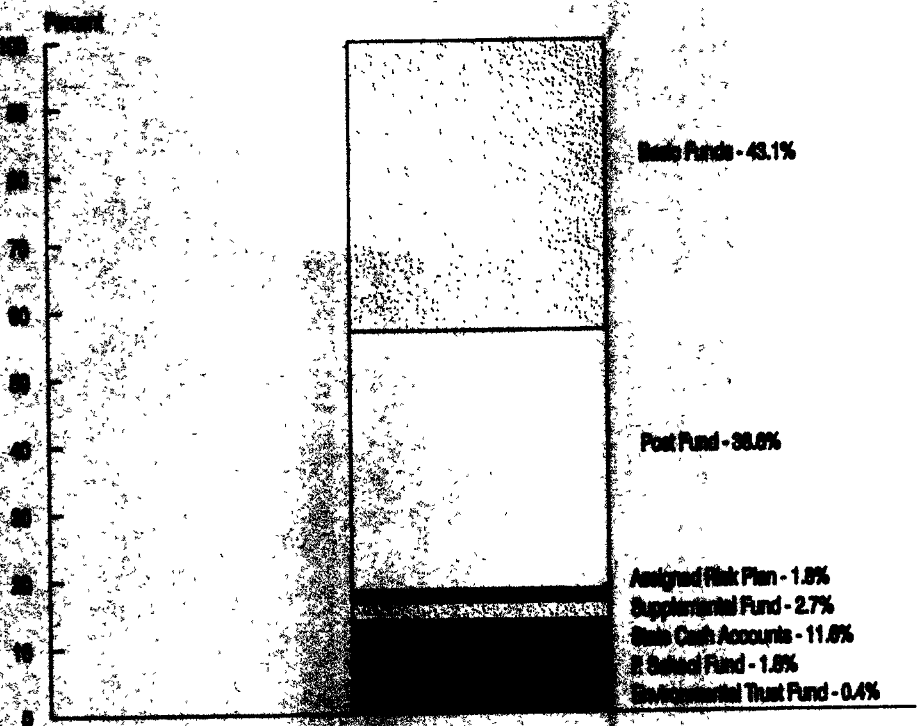
**Performance Benchmarks**
A custom benchmark has been established for the fixed income portfolio. It reflects the duration of the liability stream and the long-term sector allocation of Voyageur Asset Management. The equity benchmark is a custom benchmark consisting of A or greater rated S&P 500 stocks less utilities. The total fund benchmark is a combination of the fixed income and equity benchmarks, weighted according to the asset allocation target.

**Market Value**
On March 31, 1994 the market value of the Assigned Risk Plan was $410 million.




| | Period Ending 3/31/94 Qtr. | Yr. | Since 7/1/91 |
|---|---|---|---|
| **Total Fund** | **-1.7%** | **2.1%** | **8.5%** |
| Composite Index | -2.0 | 1.6 | 8.0 |
| | | | |
| **Equity Segment** | **-3.9** | **-5.1** | **6.5** |
| Benchmark | -4.5 | -4.1 | 6.8 |
| | | | |
| **Bond Segment** | **-1.3** | **3.4** | **9.0** |
| Benchmark | -1.3 | 2.9 | 8.2 |

# EXECUTIVE SUMMARY
## Funds Under Management




| | 3/31/94 Market Value (Billions) |
|---|---|
| Basic Retirement Funds | $ 9.7 |
| Post Retirement Fund | 8.7 |
| Assigned Risk Plan | 0.4 |
| Supplemental Investment Fund | 0.6 |
| State Cash Accounts | 2.6 |
| Permanent School Fund | 0.4 |
| Environmental Trust Fund | 0.1 |
| Total | $22.5 |

# MINNESOTA STATE BOARD OF INVESTMENT

## QUARTERLY INVESTMENT REPORT

First Quarter 1994

(January 1, 1994 — March 31, 1994)

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# VARIOUS CAPITAL MARKET INDICES

| | Period Ending 3/31/94 | | | | |
|---|---|---|---|---|---|
| | Qtr. | Yr. | 3 Yr. | 5 Yr. | 10 Yr. |
| **Domestic Equity** | | | | | |
| Wilshire 5000 | -3.7% | 2.8% | 10.4% | 12.1% | 14.3% |
| Dow Jones Industrials | -2.5 | 8.8 | 10.9 | 13.4 | 16.3 |
| S&P 500 | -3.8 | 1.5 | 9.1 | 12.1 | 14.7 |
| Russell 2000 | -2.7 | 11.0 | 15.6 | 11.7 | 11.4 |
| **Domestic Fixed Income** | | | | | |
| Salomon BIG* | -2.8 | 2.6 | 9.1 | 10.5 | 11.5 |
| Shearson Gov't./Corp. | -3.1 | 2.8 | 9.4 | 10.5 | 11.4 |
| 90 Day U.S. Treasury Bills | 0.8 | 3.1 | 3.9 | 5.5 | 6.6 |
| **International** | | | | | |
| EAFE** | 3.5 | 22.5 | 7.9 | 2.7 | 16.3 |
| Salomon Non U.S. Gov't. Bond | 1.9 | 10.8 | 14.3 | 11.1 | 14.2 |
| **Inflation Measure** | | | | | |
| Consumer Price Index*** | 1.0 | 2.6 | 3.0 | 3.8 | 3.7 |

* Salomon Broad Investment Grade bond index
** Morgan Stanley Capital International index of Europe, Australia and the Far East (EAFE)
*** Consumer Price Index (CPI) for all urban consumers, also known as CPI-U.

# FINANCIAL MARKETS REVIEW

## DOMESTIC STOCKS

For the quarter, the stock market generated negative returns. The decline was very broad producing negative returns in almost every segment of the market. As shown below, all the Wilshire Style Indexes incurred negative returns similar to the broad market. From a sector perspective, only the technology area produced a positive return. In general, the stock market posted negative returns due to rising interest rates in the bond market. The bond market reacted negatively to reports that the economy was growing faster than expectations which caused the market to fear that inflation will increase significantly.

The Wilshire 5000 provided a -3.8% return for the quarter. Performance among the different Wilshire Style Indexes for the quarter are shown below:

| | |
|---|---|
| Large Value | -4.9% |
| Small Value | -3.9 |
| Large Growth | -3.8 |
| Small Growth | -3.2 |

The Wilshire 5000 increased 2.8% during the latest year.

## DOMESTIC BONDS

Bond returns were poor as interest rates rose. As the economy strengthened, inflation fears rose and caused an increase in interest rates, including the Federal funds rate. Two year rates increased 0.95% while long rates increased 0.75%. Mortgage securities had a shorter duration and therefore outperformed corporate and Treasury securities.

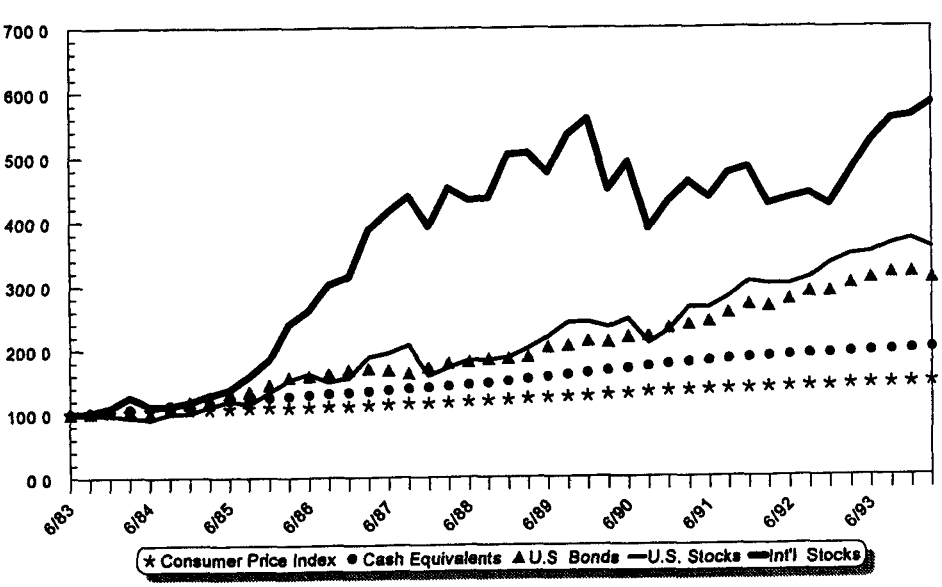
Overall, the Salomon Brothers Broad Investment Grade (BIG) Index decreased 2.8% for the quarter. The Salomon BIG sector returns for the quarter were:

| | |
|---|---|
| Treasury/Agency | -3.1% |
| Corporates | -3.2 |
| Mortgages | -2.1 |

The Salomon BIG increased 2.6% for the latest year.

## PERFORMANCE OF CAPITAL MARKETS

Cumulative Returns




Indices used are: Morgan Stanley's Index of Europe, Australia and the Far East (EAFE); Wilshire 5000 Index; Salomon Broad Investment Grade (BIG) Bond Index; 91 Day Treasury Bills; and the Consumer Price Index.

# FINANCIAL MARKETS REVIEW

## INTERNATIONAL STOCKS

In aggregate, the international stock markets (as measured by the EAFE index) provided a return of 3.5% for the quarter. As shown below, performance varied widely among the major markets.

| | |
|---|---|
| Japan | 16.3% |
| United Kingdom | -7.3 |
| Germany | -1.2 |
| France | -2.5 |

The EAFE index increased by 22.5% during the latest year. The index is compiled by Morgan Stanley Capital International. It is an index of 20 markets located in Europe, Australia and the Far East (EAFE). The major markets listed above comprise about 75% of the value of international markets.

## REAL ESTATE

Many real estate portfolios have experienced significant writedowns over the last two years, reflecting the weak real estate markets. Income returns from properties valued at current market prices are becoming more competitive with those from other asset classes. Longer term, higher property income yields, low interest rates and a significant decline in construction activity are favorable developments for the real estate market.

## PRIVATE EQUITY

According to the *Venture Capital Journal*, "venture capitalists took 165 companies public in 1993, breaking the record of 157 companies set the prior year. The capital raised in the 1993 initial public offering (IPO) market by venture-backed companies broke a record as well. A total of $4.86 billion was raised, compared with $4.57 billion the previous year."

## RESOURCE FUNDS

Currently, spot prices of West Texas Intermediate oil are $18.05 per barrel. This compares to $19.35 per barrel a year ago.

# COMBINED FUNDS

The "Combined Funds" represent the assets of both the Basic and Post Retirement Funds. While the Combined Funds do not exist under statute, the Board finds it instructive to review asset mix and performance of all defined benefit pension assets under its control. This more closely parallels the structure of other public and corporate pension plan assets and therefore allows for more meaningful comparison with other pension fund investors.

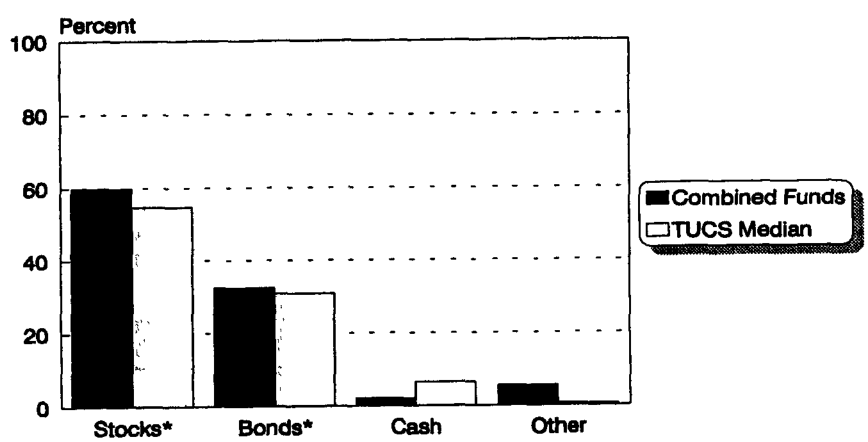
The comparison universe used by the SBI is the Master Trust portion of the Trust Universe Comparison Service (TUCS). This universe contains information on more than 200 public and corporate pension and trust funds with a balanced asset mix.

## Asset Mix Compared to Other Pension Funds

On March 31, 1994, the actual asset mix of the Combined Funds was:

| | $ Millions | % |
|---|---|---|
| Domestic Stocks | $9,127 | 49.5% |
| International Stocks | 1,922 | 10.4 |
| Bonds | 5,993 | 32.5 |
| Alternative Assets | 1,005 | 5.5 |
| Unallocated Cash | 393 | 2.1 |
| Total | $18,440 | 100.0% |

Comparisons of the Combined Funds' asset mix to the median allocation to stocks, bond and other assets of the public and corporate funds in TUCS on March 31, 1994 are shown below:




| | Stocks* | Bonds* | Cash | Other |
|---|---|---|---|---|
| **Combined Funds** | **59.9%** | **32.5%** | **2.1%** | **5.5%** |
| Median Allocation in TUCS | 54.7 | 30.9 | 6.5 | 0.6 |

* Both domestic and international.

## COMBINED FUNDS
### Performance Compared to Other Pension Funds

While the SBI is naturally concerned with how its returns compare to other pension investors, universe comparison data should be used with great care. There are several reasons why such comparisons will provide an "apples to oranges" look at performance:

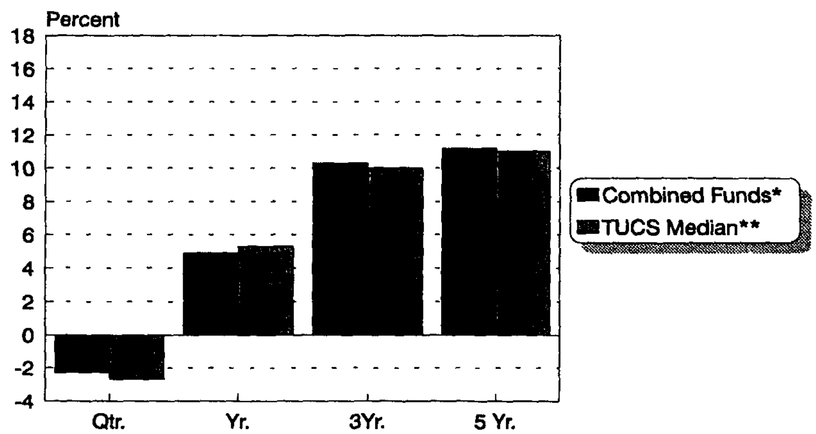
— **Differing Treatment of Fees.** All SBI returns in this report are shown *after* all management fees while TUCS data is reported *before* fees. If the SBI reported returns before fees, its returns and rankings would be *higher* than those shown in this report.

— **Differing Allocations.** Asset allocation will have a dominant effect on return. The allocation to stocks among the funds in TUCS typically ranges from 20-90%, a very wide range for meaningful comparison.

In addition, it appears that many funds do not include alternative asset holdings in their reports to TUCS. This further distorts comparisons among funds.

— **Differing Goals/Liabilities.** Each pension fund structures its portfolio to meet its own liabilities and risk tolerance. This will result in different choices on asset mix. Since asset mix will largely determine investment results, a universe ranking is not relevant to a discussion of how well a plan sponsor is meeting its long-term liabilities.

With these considerations in mind, the performance of the Combined Funds compared to other public and corporate pension funds in TUCS are shown below:




**Period Ending 3/31/94**

| | Qtr. | Yr. | 3 Yr. (Annualized) | 5 Yr. (Annualized) |
|---|---|---|---|---|
| **Combined Funds Return*** | **-2.3** | **4.9** | **10.3** | **11.2** |
| TUCS Median Fund Return** | -2.7% | 5.3% | 10.0% | 11.0% |
| Percentile Rank in TUCS | 32nd | 53rd | 44th | 44th |

* After fees. Includes Basic Funds only through 6/30/93, Basic and Post thereafter.
** Before fees

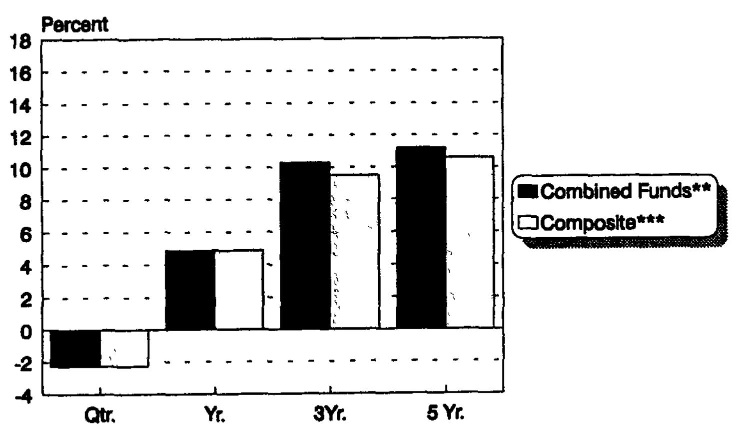
The SBI's stated performance objective is that the Combined Funds will rank in the top half of the universe (above the 50th percentile) over the most recent five year period. The SBI will strive to achieve performance which ranks in the top third (above the 33rd percentile).

## COMBINED FUNDS
### Performance Compared to Composite Index

The Combined Funds' performance is evaluated relative to a composite of market indices. The composite is weighted in a manner that reflects the asset allocation of the Combined Funds:

| | Market Index | Combined Index Weights 1/1/94 |
|---|---|---|
| Domestic Stocks | Wilshire 5000 | 50.0% |
| Int'l. Stocks | EAFE | 10.0 |
| Domestic Bonds | Salomon BIG | 32.7* |
| Alternative Assets | Wilshire Real Estate | 2.4* |
| | Venture Capital Funds | 2.4* |
| | Resource Funds | 0.6* |
| Unallocated Cash | 91 Day T-Bills | 1.9 |
| | | 100.0% |

* Alternative asset and bond weights are reset in the composite each quarter to reflect the amount of unfunded commitments in alternative asset classes.




**Period Ending 3/31/94**

| | Qtr. | Yr. | Annualized 3 Yr. | Annualized 5 Yr. |
|---|---|---|---|---|
| **Combined Funds**** | **-2.3%** | **4.9%** | **10.3%** | **11.2%** |
| Composite Index*** | -2.3 | 4.9 | 9.5 | 10.6 |

**Includes performance of Basic Funds through 6/30/93, Basic and Post Funds thereafter.

***Adjusted to reflect the SBI's restrictions on liquor and tobacco stocks through 3/31/93 and AHP restriction through 10/31/93.

# BASIC RETIREMENT FUNDS

## Investment Objectives

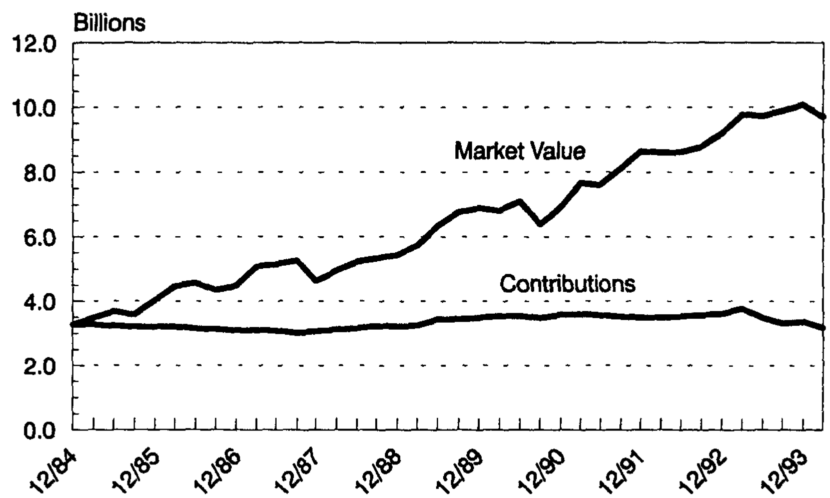
The Basic Retirement Funds are composed of the retirement assets for currently working participants in eight statewide retirement funds. The Funds serve as accumulation pools for the pension contributions of public employees and their employers during the employees' years of active service. Approximately 250,000 public employees participate in the Basic Funds.

Employee and employer contribution rates are specified in state law as a percentage of an employee's salary. The rates are set so that contributions plus expected investment earnings will cover the projected cost of promised pension benefits. In order to meet these projected pension costs, the Basic Retirement Funds must generate investment returns of at least 8.5% on an annualized basis, over time.

Normally, pension assets will accumulate in the Basic Retirement Funds for thirty to forty years during an employee's years of active service. This provides the Basic Funds with a long investment time horizon and permits the Board to take an aggressive, high expected return investment policy which incorporates a sizeable equity component in order to meet or exceed its actuarial return target.

## Asset Growth

The market value of the Basic Retirement Funds' assets decreased 3.9% during the first quarter of 1994. Negative investment returns and net withdrawals accounted for the decrease.




| | 12/89 | 12/90 | 12/91 | 12/92 | 12/93 | Latest Qtr. 3/94 |
|---|---|---|---|---|---|---|
| | Last Five Years In Millions | | | | | |
| Beginning Value | $5,420 | $6,875 | $6,919 | $8,639 | $9,191 | $10,086 |
| Net Contributions | 269 | 91 | -92 | -34 | -239 | -187 |
| Investment Return | 1,186 | -47 | 1,812 | 586 | 1,134 | -202 |
| Ending Value | $6,875 | $6,919 | $8,639 | $9,191 | $10,086 | 9,697 |

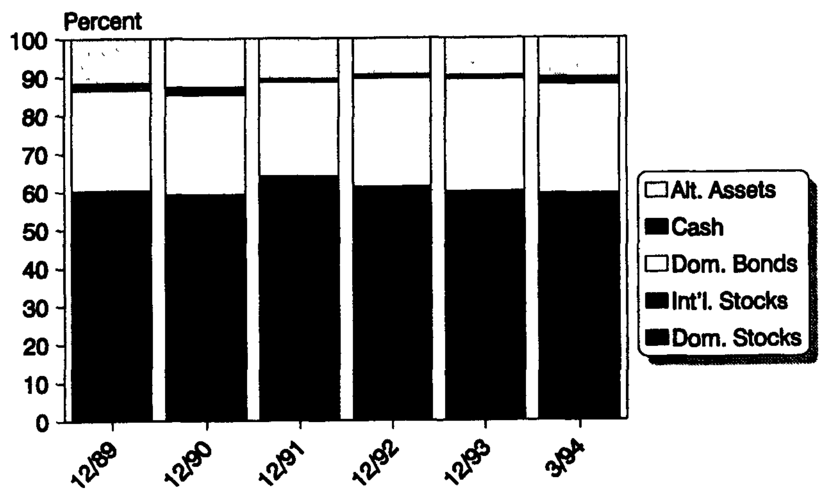
# BASIC RETIREMENT FUNDS
## Asset Mix

The long-term asset allocation of the Basic Funds is based on the superior performance of common stocks over the history of the capital markets. The asset mix is designed to add value to the Basic Funds over their long-term investment time horizon.

| | |
|---|---|
| Domestic Stocks | 50.0% |
| Int'l. Stocks | 10.0 |
| Domestic Bonds | 24.0 |
| Alternative Assets* | 15.0 |
| Unallocated Cash | 1.0 |

*Alternative assets include real estate, venture capital and resource funds.

The actual asset mix changed only slightly from the prior quarter. This was due primarily to market movements.




| | Last Five Years | | | | | Latest Qtr. |
|---|---|---|---|---|---|---|
| | 12/89 | 12/90 | 12/91 | 12/92 | 12/93 | 3/94 |
| Domestic Stocks | 60.2% | 59.1% | 63.9% | 57.9% | 49.9% | 49.0% |
| Int'l. Stocks | 0.0 | 0.0 | 0.0 | 3.2 | 10.0 | 10.3 |
| Domestic Bonds | 26.4 | 26.2 | 24.7 | 28.5 | 29.4 | 28.6 |
| Real Estate | 7.5 | 7.0 | 4.8 | 4.2 | 4.1 | 4.2 |
| Private Equity | 2.8 | 4.2 | 4.7 | 4.2 | 4.6 | 5.1 |
| Resource Funds | 1.4 | 1.5 | 1.1 | 1.2 | 1.1 | 1.0 |
| Unallocated Cash | 1.7 | 2.0 | 0.8 | 0.8 | 0.9 | 1.8 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |

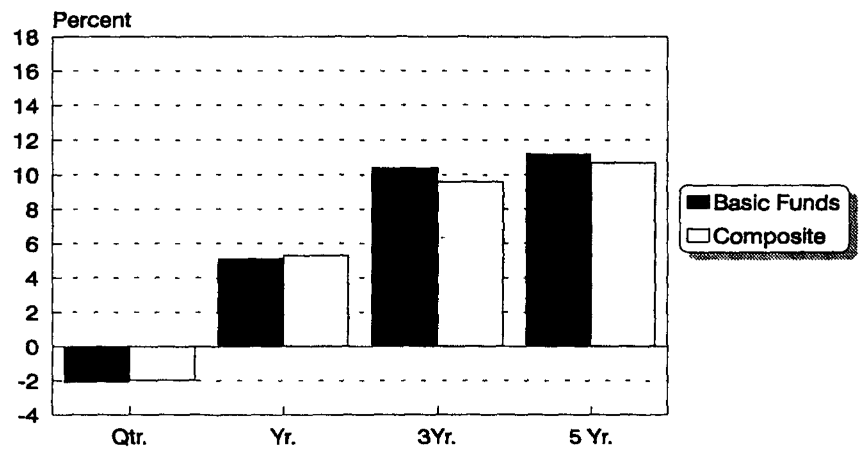
# BASIC RETIREMENT FUNDS

## Total Fund Performance

The Basic Funds' performance is evaluated relative to a composite of market indices. The composite is weighted in a manner that reflects the long-term asset allocation of the Funds:

| | Basics Target | Market Index | Basics Composite 1/1/94 |
|---|---|---|---|
| Domestic Stocks | 50.0% | Wilshire 5000 | 50.0% |
| Int'l. Stocks | 10.0 | EAFE | 10.0 |
| Domestic Bonds | 24.0 | Salomon BIG | 29.0* |
| Alternative Assets | 15.0 | Wilshire Real Estate | 4.0* |
| | | Private Equity Funds | 5.0* |
| | | Resource Funds | 1.0* |
| Unallocated Cash | 1.0 | 91 Day T-Bills | 1.0 |
| | 100.0% | | 100.0% |

* Alternative asset and bond weights are reset in the composite each quarter to reflect the amount of unfunded commitments in alternative asset classes.




**Period Ending 3/31/94**

| | Qtr. | Yr. | Annualized 3 Yr. | 5 Yr. |
|---|---|---|---|---|
| **Basic Funds** | **-2.1%** | **5.1%** | **10.4%** | **11.2%** |
| Composite Index** | -2.0 | 5.3 | 9.6 | 10.7 |

**Adjusted to reflect the SBI's restrictions on liquor and tobacco stocks through 3/31/93 and AHP restriction through 10/31/93.

Effective July 1, 1993, the Basic and Post Funds share the same stock, domestic bond and international stock managers. See page14 for the performance of these asset pools. Performance of the Basic Funds' alternative assets is on page 15.

# POST RETIREMENT FUND

The Post Retirement Investment Fund contains the pension assets of retired public employees covered by statewide retirement plans. Approximately 60,000 retirees receive monthly annuities from the assets of the Fund.

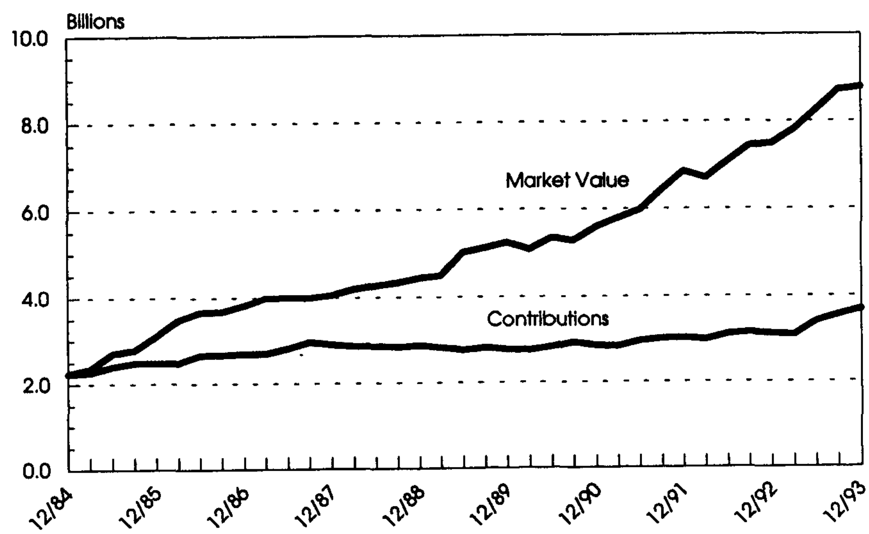
Upon an employee's retirement, a sum of money sufficient to finance the fixed monthly annuity is transferred from accumulation pools in the Basic Funds to the Post Fund. In order to support promised benefits, the Post Fund must "earn" at least 5% on its invested assets on an annualized basis. If the Post Fund exceeds this earnings rate, excess earnings are used to finance permanent benefit increases for eligible retirees.

Through fiscal year 1992, unrealized capital gains (or losses) were excluded from the statutory definition of earnings. For this reason the Post Fund previously was not designed to maximize long-term total rates of return. Rather, the SBI attempted to generate a high, consistent stream of realized earnings for the Post Fund that maintained current benefits, as well as produced benefit increases over time.

Beginning in fiscal year 1993, the post retirement benefit increase formula is based on total return rather than realized earnings. As a result, the Board has adopted a new long-term asset allocation strategy for the Post Fund which incorporates a substantial commitment to common stocks. The transition to the new asset allocation strategy was completed by the start of fiscal year 1994 (7/1/93).

## Asset Growth

The market value of the Post Retirement Fund decreased by 0.3% during the first quarter of 1994. The decrease was due to negative investment performance despite net contributions.




| | In Millions | | | | | Latest Qtr. |
|---|---|---|---|---|---|---|
| | 12/89 | 12/90 | 12/91 | 12/92 | 12/93 | 3/94 |
| Beginning Value | $4,434 | $5,238 | $5,590 | $6,855 | $7,500 | $8,766 |
| Net Contributions | 25 | 88 | 162 | 95 | 386 | 211 |
| Investment Return | 779 | 264 | 1,103 | 550 | 880 | -235 |
| Ending Value | $5,238 | $5,590 | $6,855 | $7,500 | $8,766 | $8,742 |

# POST RETIREMENT FUND

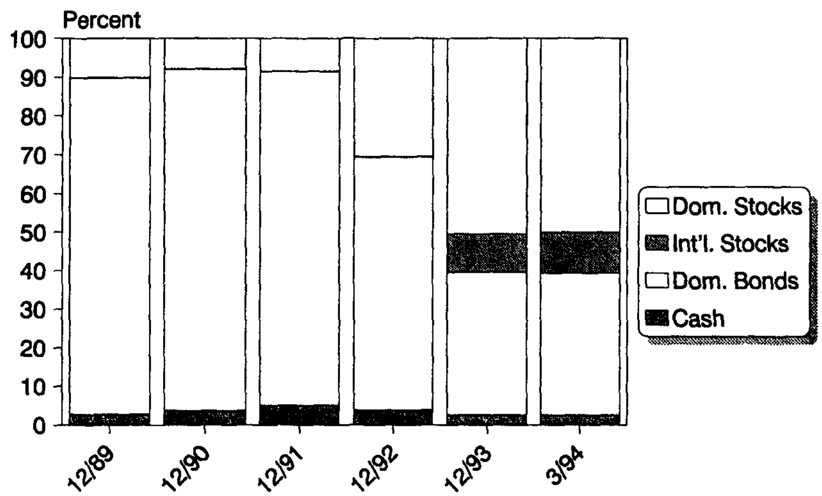
## Asset Mix

The Board adopted a new asset allocation strategy for the Post Fund in fiscal year 1993 which reflects the new post retirement benefit increase formula recently enacted by the Legislature. Throughout fiscal year 1993, the actual asset mix of the Post Fund moved toward a 50% allocation to common stocks. In fiscal year 1994, the Board added allocations to international stocks and alternative investments.

| | |
|---|---|
| Domestic Stocks | 50.0% |
| Int'l. Stocks | 10.0 |
| Domestic Bonds | 32.0 |
| Alternative Assets | 5.0 |
| Unallocated Cash | 3.0 |
| Total | 100.0% |

The large allocation to common stocks will allow the Fund to increase the long-term earning power of its assets and allow the Fund to focus on generating higher long-term total rates of return.

Funding for alternative assets began during the quarter with a small private equity investment. International stocks are slightly above the target allocation due to market movements.




| | Last Five years | | | | | Latest Qtr. |
|---|---|---|---|---|---|---|
| | 12/89 | 12/90 | 12/91 | 12/92 | 12/93 | 3/94 |
| Dom. Stocks | 10.2% | 7.9% | 8.5% | 30.6% | 50.5% | 50.1% |
| Int'l. Stocks | 0.0 | 0.0 | 0.0 | 0.0 | 10.0 | 10.6 |
| Dom. Bonds | 87.1 | 88.5 | 80.0 | 65.6 | 36.9 | 36.8 |
| Alt. Assets | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0* |
| Unallocated Cash | 2.7 | 3.6 | 5.0 | 3.8 | 2.6 | 2.5 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |

* less than 0.1%

# POST RETIREMENT FUND

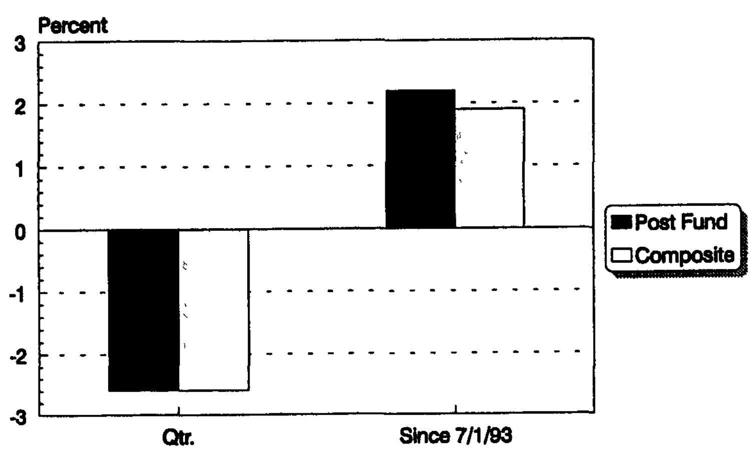
## Total Fund Performance

The Post Fund's performance is evaluated relative to a composite of market indices. The composite is weighted in a manner that reflects the long-term asset allocation of the Fund:

| Asset Class | Post Target | Market Index | Post Composite 1/1/94 |
|---|---|---|---|
| Domestic Stocks | 50% | Wilshire 5000 | 50.0% |
| Int'l. Stocks | 10 | EAFE | 10.0 |
| Domestic Bonds | 32 | Salomon BIG | 37.0* |
| Alternative Assets | 5 | --- | 0.0* |
| Unallocated Cash | 3 | 91 Day T-Bills | 3.0 |
| | 100% | | 100.0% |

* Until the alternative asset allocation is fully funded, the composite will be overweighted in bonds.

The asset mix of the Post Fund was moved toward a 50% stock allocation during fiscal year 1993. The performance of the fund since the transition was completed is shown below.




| | Qtr. | Since 7/1/93 |
|---|---|---|
| **Post Fund** | **-2.6%** | **2.2%** |
| Composite Index | -2.6 | 1.9 |

Effective July 1, 1993, the Basic and Post Funds share the same domestic stock, domestic bond and international stock managers. See page14 for the performance of these asset pools.

# STOCK AND BOND MANAGERS

## Performance of Asset Pools

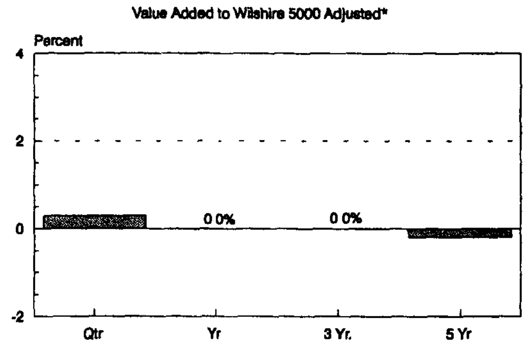
### Domestic Stock Pool

Target: Wilshire 5000 Adjusted*

**Expectation:** If half of the pool is actively managed and half is passively managed, the entire pool is expected to exceed the target by +.20-.45% annualized, over time.

| | Qtr. | Yr. | Annualized 3 Yrs. | 5 Yrs. |
|---|---|---|---|---|
| **Stock Pool** | **-3.5%** | **2.5%** | **10.3%** | **11.6%** |
| Wilshire 5000* | -3.8 | 2.5 | 10.3 | 11.8 |

*Buy/hold index adjusted for liquor and tobacco restrictions through 3/31/93 and AHP restriction through 10/31/93.

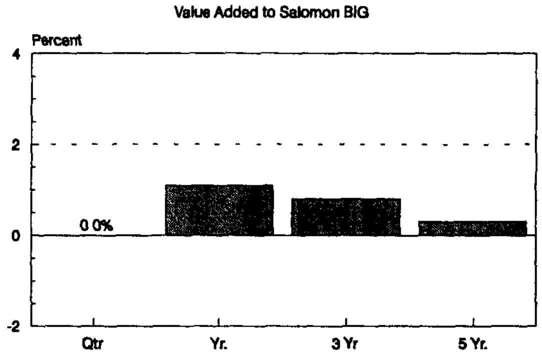



### Domestic Bond Pool

**Target:** Salomon Broad Investment Grade (BIG) Index

**Expectation:** If half of the pool is actively managed and half is managed semi-passively, the entire pool is expected to exceed the target by +.20-.35% annualized, over time.

| | Qtr. | Yr. | Annualized 3 Yrs. | 5 Yrs. |
|---|---|---|---|---|
| **Bond Pool** | **-2.8%** | **3.6%** | **9.9%** | **10.8%** |
| Salomon BIG | -2.8 | 2.6 | 9.1 | 10.5 |

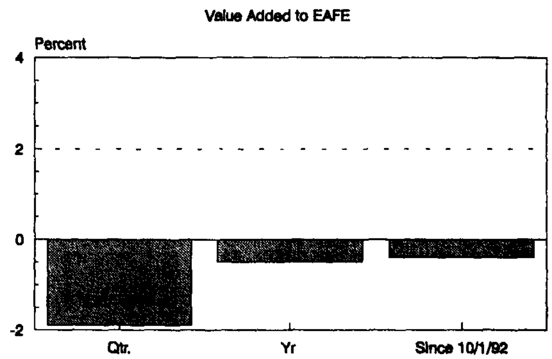



### International Stock Pool

**Target:** EAFE

**Expectation:** If half of the pool is managed actively and half managed passively, the entire pool is expected to exceed the target by +.25-.75% annualized, over time.

| | Qtr. | Yr. | Since 10/1/92 |
|---|---|---|---|
| **Int'l. Pool** | **1.6%** | **22.0%** | **19.9%** |
| EAFE | 3.5 | 22.5 | 20.3 |



# ALTERNATIVE ASSET MANAGERS
## Performance of Asset Pools

### Real Estate Pool (Basic Funds only)

**Expectation: Real estate investments** are expected to exceed the rate of inflation by 3-5% annualized, over the life of the investment.

The Wilshire Real Estate Index contains returns of 30 commingled funds. The index does not include returns from funds that are less than 3 years old or are not fully invested.

| | | | Annualized | |
|---|---|---|---|---|
| | Qtr. | Yr. | 3 Yrs. | 5 Yrs. |
| **Real Estate** | **-1.3%** | **-1.2%** | **-5.9%** | **-3.1%** |
| Real Estate Index | -1.3 | -4.0 | -7.6 | -4.4 |
| Inflation | 1.0 | 2.5 | 2.9 | 3.8 |

### Private Equity Pool (Basic Funds only)

**Expectation: Private equity investments** (primarily venture capital) are expected to provide annualized returns at least 3% greater than historical public equity returns, over the life of the investment. This equates to an absolute return of approximately 13-14% annualized.

The SBI began its venture capital programs in the mid-1980's. Some of the investments, therefore, are relatively immature and returns may not be indicative of future results.

| | | | Annualized | |
|---|---|---|---|---|
| | Qtr. | Yr. | 3 Yrs. | 5 Yrs. |
| **Private Equity** | **8.5%** | **25.0%** | **21.3%** | **16.8%** |

### Resource Pool (Basic Funds only)

Expectation: Resource investments (primarily oil and gas) are expected to exceed the rate of inflation by 3-5% annualized, over the life of the investment.

The SBI began its resource program in the mid-1980's. Some of the investments, therefore, are relatively immature and returns may not be indicative of future results.

| | | | Annualized | |
|---|---|---|---|---|
| | Qtr. | Yr. | 3 Yrs. | 5 Yrs. |
| **Resource Funds** | **-1.0%** | **4.4%** | **6.4%** | **5.5%** |

# ASSIGNED RISK PLAN

**Investment Objective**
The Assigned Risk Plan has two investment objectives: to minimize the mismatch between assets and liabilities and to provide sufficient liquidity for the payment of on-going claims and operating expenses.

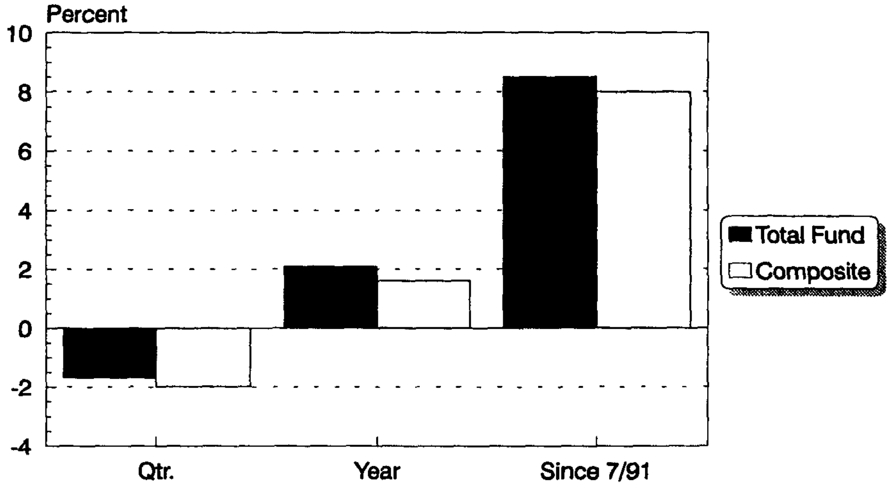
**Asset Mix**
The Assigned Risk Plan is invested in a balanced portfolio of common stocks and bonds. The actual asset mix will fluctuate in response to changes in the Plan's liability stream.

| | 3/31/94 Target | 3/31/94 Actual |
|---|---|---|
| Stocks | 20.0% | 17.8% |
| Bonds | 80.0 | 78.4 |
| Unallocated Cash | 0.0 | 3.8 |
| | 100.0% | 100.0% |

**Investment Management**
The entire fund is managed externally by Voyageur Asset Management. The portfolio was transferred from the Department of Commerce to the SBI on May 1, 1991.

**Performance Benchmarks**
A custom benchmark has been established for the fixed income portfolio. It reflects the duration of the liability stream and the long-term sector allocation of Voyageur Asset Management. The equity benchmark is a custom benchmark consisting of A or greater rated S&P 500 stocks less utilities. The total fund benchmark is a combination of the fixed income and equity benchmarks, weighted according to the asset allocation target.

**Market Value**
On March 31, 1994 the market value of the Assigned Risk Plan was $410 million.




| | Period Ending 3/31/94 Qtr. | Yr. | Since 7/1/91 |
|---|---|---|---|
| **Total Account** | **-1.7%** | **2.1%** | **8.5%** |
| Composite | -2.0 | 1.6 | 8.0 |
| | | | |
| **Equity Segment** | **-3.9** | **-5.1** | **6.5** |
| Benchmark | -4.5 | -4.1 | 6.8 |
| | | | |
| **Bond Segment** | **-1.3** | **3.4** | **9.0** |
| Benchmark | -1.3 | 2.9 | 8.2 |

# SUPPLEMENTAL INVESTMENT FUND

The Minnesota Supplemental Investment Fund is a multi-purpose investment program that offers a range of investment options to state and local public employees. The different participating groups use the Fund for a variety of purposes:

1. It functions as the investment manager for all assets of the Unclassified Employees Retirement Plan and the Public Employees Defined Contribution Plan.

2. It acts as an investment manager for most assets of the supplemental retirement programs for state university and community college teachers and for Hennepin County employees.

3. It is one investment vehicle offered to public employees as part of the state's Deferred Compensation Plan.

4. It serves as an external money manager for a portion of some local police and firefighter retirement plans.

A wide diversity of investment goals exists among the Fund's participants. In order to meet those needs, the Fund has been structured much like a "family of mutual funds." Participants may allocate their investments among one or more accounts that are appropriate for their needs, within the statutory requirements and rules established by the participating organizations. Participation in the Fund is accomplished through the purchase or sale of shares in each account.

The investment returns shown in this report are calculated using a time-weighted rate of return formula. These returns may differ slightly from calculations based on share values, due to the movement of cash flows in and out of the accounts.

**On March 31, 1994 the market value of the entire fund was $611 million.**

## Investment Options

**Income Share Account** - a balanced portfolio utilizing both common stocks and bonds.

**Growth Share Account** - an actively managed, all common stock portfolio.

**Common Stock Index Account** - a passively managed, all common stock portfolio designed to track the performance of the entire stock market.

**Bond Market Account** - an actively managed, all bond portfolio.

**Money Market Account** - a portfolio utilizing short-term, liquid debt securities.

**Fixed Interest Account** - an option utilizing guaranteed investment contracts (GIC's), which offer a fixed rate of return for a specified period of time.

# SUPPLEMENTAL INVESTMENT FUND

## Income Share Account

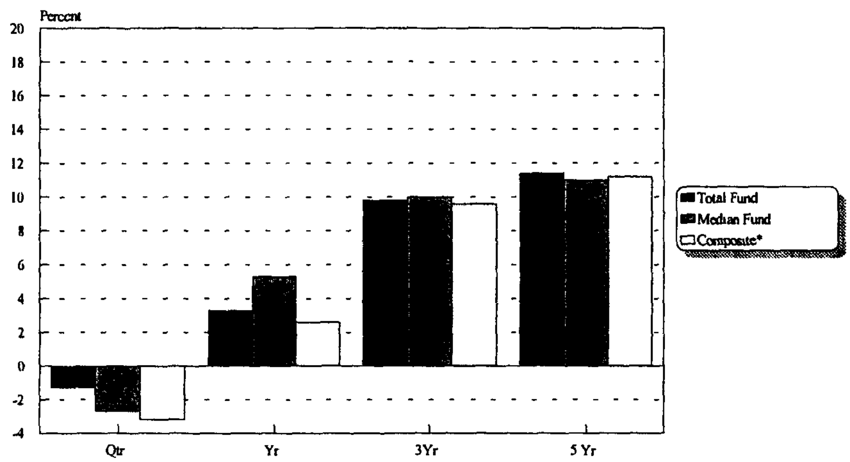
**Investment Objective**
The primary investment objective of the Income Share Account is similar to that of the Basic Retirement Funds. The Account seeks to maximize long-term real rates of return, while limiting short-run portfolio return volatility.

**Asset Mix**
The Income Share Account is invested in a balanced portfolio of common stocks and bonds. Common stocks provide the potential for significant capital appreciation, while bonds act as a deflation hedge and provide portfolio diversification.

| | Target | Actual |
|---|---|---|
| Stocks | 60.0% | 61.9% |
| Bonds | 35.0 | 31.6 |
| Unallocated Cash | 5.0 | 6.5 |
| | 100.0% | 100.0% |

**Investment Management**
The Account combines internal and external management. Internal investment staff manage the entire fixed income segment. Throughout the period shown below, the entire stock segment has been managed by Wilshire Associates as part of a passively managed index fund designed to track the Wilshire 5000. Prior to April 1988, a significant portion of the stock segment was actively managed.

**Market Value**
On March 31, 1994 the market value of the Income Share Account was $315 million.




**Period Ending 3/31/94**

| | Qtr. | Yr. | Annualized 3 Yr. | 5 Yr. |
|---|---|---|---|---|
| **Total Account** | **-3.1%** | **3.3%** | **9.8%** | **11.4%** |
| Median Fund* | -2.7 | 5.3 | 10.0 | 11.0 |
| Composite** | -3.2 | 2.6 | 9.6 | 11.2 |
| | | | | |
| **Equity Segment** | **-3.5** | **3.6** | **10.8** | **12.1** |
| Wilshire 5000*** | -3.8 | 2.5 | 10.3 | 11.8 |
| | | | | |
| **Bond Segment** | **-2.8** | **3.2** | **9.5** | **10.6** |
| Salomon Bond Index | -2.8 | 2.6 | 9.1 | 10.5 |

*TUCS Median Master Trust

**60% Wilshire 5000/35% Salomon Broad Bond Index/5% T-Bills Composite. Wilshire 5000 is adjusted as noted below.

*** Buy/hold index adjusted for liquor and tobacco restrictions through 3/31/93 and AHP restricition through 10/31/93.

# SUPPLEMENTAL INVESTMENT FUND
## Growth Share Account

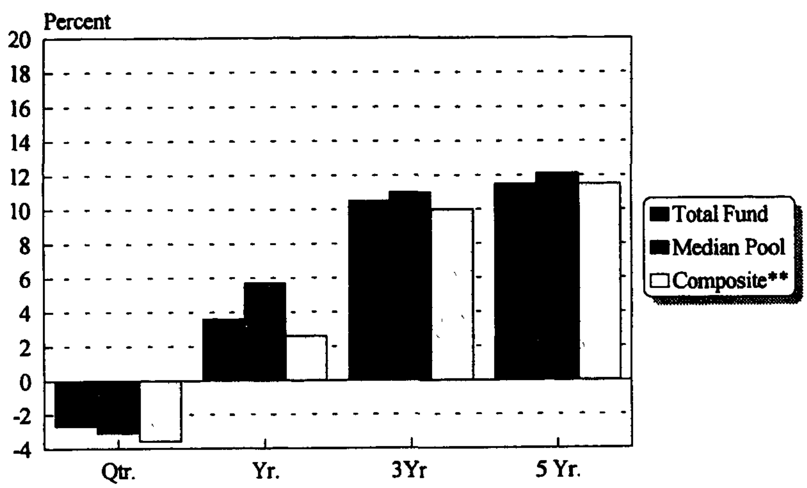
**Investment Objective**
The Growth Share Account's investment objective is to generate above-average returns from capital appreciation on common stocks.

**Asset Mix**
The Growth Share Account is invested almost entirely in common stocks. Generally, the small cash equivalents component represents the normal cash reserves held by the Account as a result of net contributions not yet allocated to stocks or held in reserve to accomodate withdrawals.

| | Target | Actual |
|---|---|---|
| Stocks | 95.0% | 95.8% |
| Unallocated Cash | 5.0 | 4.2 |
| | 100.0% | 100.0% |

**Investment Management**
Throughout the period shown below, the entire Account has been managed by the same group of active external stock managers utilized by the Basic and Post Retirement Funds. Prior to April 1988, other active managers controlled a substantial portion of the account.

**Market Value**
On March 31, 1994 the market value of the Growth Share Account was $102 million.




**Period Ending 3/31/94**

| | Qtr. | Yr. | 3 Yr. (Annualized) | 5 Yr. (Annualized) |
|---|---|---|---|---|
| **Total Account** | **-2.7%** | **3.6%** | **10.5%** | **11.5%** |
| Median Pool* | -3.1 | 5.7 | 11.0 | 12.1 |
| Composite** | -3.6 | 2.6 | 10.0 | 11.5 |

* TUCS Median Equity Pool

** 95% Wilshire 5000/5% T-Bills Composite. Wilshire 5000 buy/hold index is adjusted for liquor and tobacco restrictions through 3/31/93 and AHP restriction through 10/31/93.

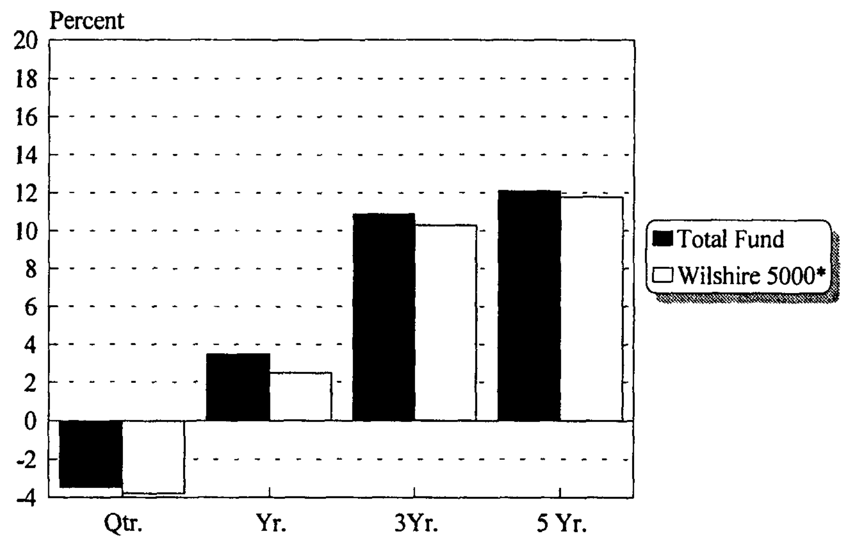
# SUPPLEMENTAL INVESTMENT FUND
## Common Stock Index Account

**Investment Objective and Asset Mix**
The investment objective of the Common Stock Index Account is to generate returns that match those of the common stock market. The Account is designed to track the performance of the Wilshire 5000, a broad-based equity market indicator.

The Account is invested 100% in common stock.

**Investment Management**
The entire Account is managed by Wilshire Associates as part of a passively managed index fund.

**Market Value**
On March 31, 1994 the market value of the Common Stock Index Account was $45 million.




**Period Ending 3/31/94**

| | | | Annualized | |
|---|---|---|---|---|
| | **Qtr.** | **Yr.** | **3 Yr.** | **5 Yr.** |
| **Total Account** | **-3.5%** | **3.5%** | **10.9%** | **12.1%** |
| Wilshire 5000* | -3.8 | 2.5 | 10.3 | 11.8 |

*Buy/hold index adjusted for liquor and tobacco restrictions through 3/31/93 and AHP restriction through 10/31/93.

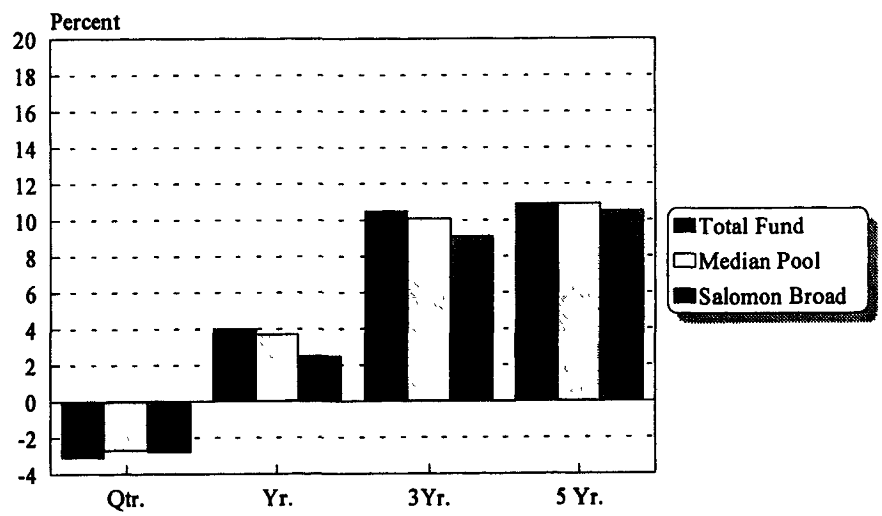
# SUPPLEMENTAL FUND
## Bond Market Account

**Investment Objective**
The investment objective of the Bond Market Account is to earn a high rate of return by investing in fixed income securities.

**Asset Mix**
The Bond Market Account invests primarily in high-quality, government and corporate bonds that have intermediate to long-term maturities, usually 3 to 20 years.

**Investment Management**
The entire Account is managed by the same group of active external bond managers utilized by the Basic and Post Retirement Funds.

**Market Value**
On March 31, 1994 the market value of the Bond Market Account was $22 million.




**Period Ending 3/31/94**

| | Qtr. | Yr. | Annualized 3 Yr. | Annualized 5 Yr. |
|---|---|---|---|---|
| **Total Account** | **-3.1%** | **4.0%** | **10.5%** | **10.9%** |
| Median Pool* | -2.7 | 3.7 | 10.1 | 10.9 |
| Salomon BIG** | -2.8 | 2.6 | 9.1 | 10.5 |

* TUCS Median Fixed Income Pool
** Salomon Broad Investment Grade Index

# SUPPLEMENTAL INVESTMENT FUND

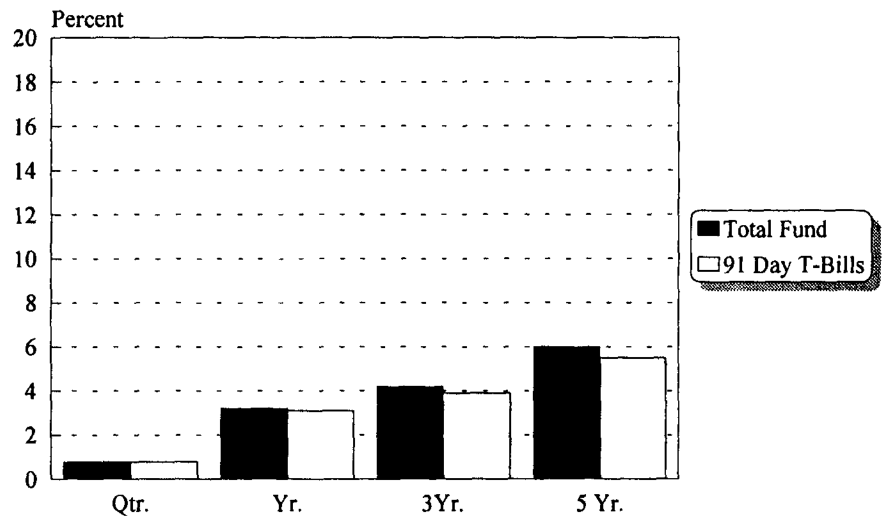
## Money Market Account

**Investment Objective**
The investment objective of the Money Market Account is to purchase short-term, liquid fixed income investments that pay interest at rates competitive with those available in the money markets.

**Asset Mix**
The Money Market Account is invested entirely in high quality short-term investments such as U.S. Treasury Bills, bank certificates of deposit, repurchase agreements, and high grade commercial paper. The average maturity of these investments is 30 to 60 days.

**Investment Management**
The Money Market Account is managed solely by State Street Bank and Trust Company. State Street manages a major portion of the Board's cash reserves.

**Market Value**
On March 31, 1994 the market value of the Money Market Account was $60 million.




| | Period Ending 3/31/94 | Annualized | | |
|---|---|---|---|---|
| | Qtr. | Yr. | 3 Yr. | 5 Yr. |
| **Total Account** | **0.8%** | **3.2%** | **4.2%** | **6.0%** |
| 91 Day T-Bills | 0.8 | 3.1 | 3.9 | 5.5 |

# SUPPLEMENTAL INVESTMENT FUND

## Fixed Interest Account

**Investment Objectives**
The investment objectives of the Fixed Interest Account are to protect investors from any loss of their original investment and to provide a fixed rate of return over a three year period.

**Asset Mix**
The Fixed Interest Account is invested in guaranteed investment contracts (GIC's) offered by major U.S. insurance companies and banks.

**Investment Management**
Annually, the Board accepts bids from banks and insurance companies that meet the financial quality criteria defined by State statute. Generally, the insurance company or bank offering the highest three year GIC interest rate is awarded the contract. That interest rate is then offered to participants who make contributions to the Fixed Interest Account over the following twelve months.

**Market Value**
On March 31, 1994 the market value of the Fixed Interest Account was $67 million.

| Contract Period | Annual Effective Interest Rate | Manager |
|---|---|---|
| Nov. 1, 1991-Oct. 31, 1994 | 6.634% | Continental Assurance/Provident National (blended rate) |
| Nov. 1, 1992-Oct. 31, 1995 | 5.280% | Norwest Bank Minnesota |
| Nov. 1, 1993-Oct. 31, 1996 | 4.625% | Principal Mutual/Hartford Life (blended rate) |

# PERMANENT SCHOOL FUND

**Investment Objectives**
The SBI invests the Permanent School Fund to produce a high, consistent level of income that will assist in offsetting state expenditures on school aids.

The Permanent School Fund's investment objectives have been influenced by the legal provisions under which its investments must be managed. These provisions require that the Permanent School Fund's principal remain inviolate. Further, any net realized equity and fixed income capital gains must be added to principal. Moreover, if the Permanent School Fund realizes net capital losses, these losses must be offset against interest and dividend income before such income can be distributed. Finally, all interest and dividend income must be distributed in the year in which it is earned.

These legal provisions have limited the investment time horizon over which the Permanent School Fund is managed. Long-run growth in its assets is difficult to achieve without seriously reducing current spendable income and exposing the spendable income stream to unacceptable volatility. The SBI, therefore, has invested the Permanent School Fund's assets to produce the maximum amount of current income, within the constraint of maintaining adequate portfolio quality.

**Asset Mix**
The Permanent School Fund continues to hold only fixed income securities.

| | Target | Actual |
|---|---|---|
| Bonds | 95.0% | 99.3% |
| Unallocated Cash | 5.0 | 0.7 |
| Total | 100.0% | 100.0% |

**Investment Management**
The entire fund is managed by the SBI investment staff.

**Asset Growth**
The market value of the Permanent School Fund's assets decreased 7.3% during the first quarter primarily due to negative investment returns and net withdrawals.

**Asset Growth**
**During First Quarter 1994**
**(Millions)**

| | |
|---|---|
| Beginning Value | $452.3 |
| Net Contributions | -13.8 |
| Investment Return | -19.1 |
| Ending Value | $419.4 |

**Bond Segment Performance**
The composition of the Permanent School Fund's bond portfolio was essentially unchanged during the quarter. The bond portfolio is structured with a laddered distribution of maturities to minimize the Fund's exposure to re-investment rate risk. At the quarter's-end, the portfolio had a current yield of 7.71%, duration of 7.60 years, and a AAA quality rating. The portfolio remains concentrated in Treasury issues with the remainder primarily distributed among mortgages, industrials and utilities.

**Bond Portfolio Statistics**
**3/31/94**

| | |
|---|---|
| Value at Market | $409,126,485 |
| Value at Cost | 382,442,981 |
| Average Coupon | 8.40% |
| Current Yield | 7.71 |
| Yield to Maturity | 7.23 |
| Current Yield at Cost | 8.25 |
| Average Time to Maturity | 15.02 |
| Duration | 7.60 |
| Average Quality Rating | AAA |
| Number of Issues | 110 |
| Treasury | 59.9% |
| Agency | 0.0 |
| Corporate | 18.8 |
| Mortgages | 21.3 |
| Total | 100.0% |

# STATE CASH ACCOUNTS

**Description**
State Cash Accounts represent the cash balances in more than 200 separate accounts that flow through the Minnesota State Treasury. These accounts range in size from $5,000 to over $400 million.

Most accounts are invested by SBI staff through two short-term pooled funds:

1. Trust Fund Pool contains the cash balances of retirement-related accounts managed internally and cash balances in the Permanent School Fund.

2. Treasurer's Cash Pool contains the cash balances of special or dedicated accounts necessary for the operation of certain State agencies and the balance of the Invested Treasurer's Cash.

In addition, each State of Minnesota bond sale requires two additional pools; one for bond proceeds and one for the debt reserve transfer.

Because of special legal restrictions, a small number of cash accounts cannot be commingled. These accounts are invested separately.

**Investment Objectives**

**Safety of Principal.** To preserve capital.

**Competitive Rate of Return.** To provide a high level of current income.

**Liquidity.** To meet cash needs without the forced sale of securities at a loss.

**Asset Mix**
The SBI maximizes current income while preserving capital by investing all cash accounts in high quality, liquid short term investments. These include U.S. Treasury and Agency issues, repurchase agreements, bankers acceptances, commercial paper, and certificates of deposit.

**Investment Management**
All state cash accounts are managed by the SBI investment staff. As noted above, most of the assets of the cash accounts are invested through two large commingled investment pools.

**Period Ending 3/31/94**

| | Market Value (Millions) | Qtr. | Yr. | 3 Yrs. Annualized |
|---|---|---|---|---|
| **Treasurer's Cash Pool** | **$2,185** | **0.5%** | **3.4%** | **5.3%** |
| **Trust Fund Cash Pool** | **23** | **0.8** | **3.4** | **4.9** |
| Benchmark* | | 0.5 | 3.2 | N.A. |
| 91-Day T-Bills | | 0.8 | 3.1 | 3.9 |

* 75% State Street Short Term Investment Fund/25% 1-3 Year Treasuries. This benchmark was established in April 1993. The Investment Advisory Council (IAC) intend to review the appropriateness of this benchmark in FY96. Until that time the IAC believe the pools should continue to be monitored against 91-Day T-Bills.

# Tab B

# PORTFOLIO STATISTICS

# STATE OF MINNESOTA
# STATE BOARD OF INVESTMENT
## Composition of State Investment Portfolios By Type of Investment
## Market Value March 31, 1993
## (in Millions)

| | Cash And Short Term Securities | Bonds | | Stocks | | External Int'l. | Alternative Assets | Total |
|---|---|---|---|---|---|---|---|---|
| | | Internal | External | Internal | External | | | |
| **BASIC RETIREMENT FUNDS:** | | | | | | | | |
| **Teachers Retirement Fund** | $74,032<br>1.73% | $0 | $1,221,975<br>28.59% | $0 | $2,097,177<br>49.06% | $440,874<br>10.31% | $440,926<br>10.31% | $4,274,984<br>100% |
| **Public Employees Retirement Fund** | $39,294<br>1.89% | $0 | $593,924<br>28.55% | $0 | $1,018,952<br>48.97% | $214,071<br>10.29% | $214,361<br>10.30% | $2,080,602<br>100% |
| **State Employees Retirement Fund** | $31,842<br>1.66% | $0 | $548,124<br>28.53% | $0 | $939,872<br>48.93% | $197,441<br>10.28% | $203,733<br>10.60% | $1,921,012<br>100% |
| **Public Employees Police & Fire Fund** | $16,809<br>1.77% | $0 | $271,195<br>28.58% | $0 | $465,270<br>49.04% | $97,749<br>10.30% | $97,775<br>10.31% | $948,798<br>100% |
| **Highway Patrol Retirement Fund** | $3,618<br>2.46% | $0 | $41,726<br>28.38% | $0 | $71,586<br>48.69% | $15,039<br>10.23% | $15,047<br>10.24% | $147,016<br>100% |
| **Judges Retirement Fund** | $141<br>1.61% | $0 | $2,500<br>28.63% | $0 | $4,289<br>49.12% | $901<br>10.32% | $901<br>10.32% | $8,732<br>100% |
| **Public Employees P.F. Consolidated** | $8,501<br>4.02% | $7,001<br>3.31% | $55,526<br>26.26% | $15<br>0.01% | $101,182<br>47.85% | $19,583<br>9.26% | $19,649<br>9.29% | $211,457<br>100% |
| **Correctional Employees Retirement** | $1,697<br>1.61% | $0 | $30,092<br>28.63% | $0 | $51,626<br>49.12% | $10,846<br>10.32% | $10,850<br>10.32% | $105,111<br>100% |
| **POST RETIREMENT FUND** | $217,476<br>2.49% | $0 | $3,220,768<br>36.84% | $0 | $4,378,909<br>50.09% | $925,367<br>10.58% | $0 | $8,742,520<br>100% |

| | Cash And Short Term Securities | Bonds Internal | Bonds External | Stocks Internal | Stocks External | External Int'l | Alternative Assets | Total |
|---|---|---|---|---|---|---|---|---|
| **MINNESOTA SUPPLEMENTAL FUNDS:** | | | | | | | | |
| Income Share Account | $20,586<br>6.53% | $99,472<br>31.56% | $0 | $0 | $195,107<br>61.91% | $0 | $0 | $315,165<br>100% |
| Growth Share Account | $4,275<br>4.18% | $0 | $0 | $0 | $97,881<br>95.82% | $0 | $0 | $102,156<br>100% |
| Money Market Account | $60,296<br>100% | $0 | $0 | $0 | $0 | $0 | $0 | $60,296<br>100% |
| Common Stock Index Account | $0 | $0 | $0 | $0 | $44,705<br>100% | $0 | $0 | $44,705<br>100% |
| Bond Market Account | $0 | $0 | $21,729<br>100% | $0 | $0 | $0 | $0 | $21,729<br>100% |
| Fixed Interest Account | $0 | $0 | $66,934<br>100% | $0 | $0 | $0 | $0 | $66,934<br>100% |
| TOTAL RETIREMENT FUNDS | $478,567<br>2.51% | $106,473<br>0.56% | $6,074,493<br>31.89% | $15<br>0.00% | $9,466,556<br>49.69% | $1,921,871<br>10.09% | $1,003,242<br>5.26% | $19,051,217<br>100% |
| ASSIGNED RISK PLAN | $15,465<br>3.77% | $0 | $321,751<br>78.41% | $0 | $73,143<br>17.82% | $0 | $0 | $410,359<br>100% |
| ENVIRONMENTAL TRUST FUND | $0 | $36,452<br>51.07% | $0 | $34,921<br>48.93% | $0 | $0 | $0 | $71,373<br>100% |
| PERMANENT SCHOOL FUND | $2,874<br>0.69% | $416,505<br>99.31% | $0 | $0 | $0 | $0 | $0 | $419,379<br>100% |
| TREASURERS CASH | $2,194,242<br>100% | $0 | $0 | $0 | $0 | $0 | $0 | $2,194,242<br>100% |
| HOUSING FINANCE AGENCY | $63,012<br>28.87% | $154,257<br>70.68% | $0 | $969<br>0.45% | $0 | $0 | $0 | $218,238<br>100% |
| MINNESOTA DEBT SERVICE FUND | $12,923<br>47.44% | $14,317<br>52.56% | $0 | $0 | $0 | $0 | $0 | $27,240<br>100% |
| MISCELLANEOUS ACCOUNTS | $52,290<br>31.36% | $114,437<br>68.64% | $0 | $0 | $0 | $0 | $0 | $166,727<br>100% |
| GRAND TOTAL | $2,819,373<br>12.50% | $842,441<br>3.73% | $6,396,244<br>28.35% | $35,905<br>0.16% | $9,539,699<br>42.29% | $1,921,871<br>8.52% | $1,003,242<br>4.45% | $22,558,775<br>100% |

## STATE OF MINNESOTA
## STATE BOARD OF INVESTMENT

### Net Cash Flow Available For Investment
### December 31, 1993 - March 31, 1994

| | |
|---|---|
| Teachers Retirement Fund | $39,000,000.00 |
| Public Employees Retirement Fund | (162,000,000.00) |
| State Employees Retirement Fund | (64,969,000.00) |
| Public Employees Police & Fire | 2,500,000.00 |
| Highway Patrol Retirement Fund | 1,266,000.00 |
| Judges Retirement Fund | 0.00 |
| Public Employees P&F Consolidated | (3,994,020.94) |
| Correctional Employees Retirement Fund | 540,000.00 |
| Post Retirement Fund | 212,401,243.81 |
| Supplemental Retirement Fund - Income | (7,260,557.90) |
| Supplemental Retirement Fund - Growth | (359,190.71) |
| Supplemental Retirement Fund - Money Market | (2,016,651.87) |
| Supplemental Retirement Fund - Index | 2,144,159.99 |
| Supplemental Retirement Fund - Bond Market | 53,852.68 |
| Supplemental Retirement Fund - Fixed Interest | (1,908,425.33) |
| **Total Retirement Funds Net Cash Flow** | **$15,397,409.72** |
| Assigned Risk Plan | ($1,347,986.42) |
| Permanent School Fund | (13,753,073.12) |
| **Total Net Cash Flow** | **$296,350.18** |

**STATE OF MINNESOTA**

**STATE BOARD OF INVESTMENT**

**Transaction and Asset Summary**

**Retirement Funds**

| | Net Transactions | | | Asset Summary (at Market Value) | | | | |
|---|---|---|---|---|---|---|---|---|
| | Bonds (Millions) | Stocks (Millions) | Total (Millions) | Cash Flow (Millions) | Short-Term % of Fund | Bonds % of Fund | Equity % of Fund | Total Mkt. Value (Millions) |
| **January 1991** | 6 | -2 | 4 | 47 | 3.6 | 52.3 | 44.1 | 13,356 |
| February | -6 | 11 | 5 | 60 | 3.9 | 50.6 | 45.5 | 13,790 |
| March | 82 | 1 | 83 | 6 | 3.3 | 50.8 | 45.9 | 13,961 |
| April | -24 | -9 | -33 | 9 | 3.6 | 50.9 | 45.5 | 14,045 |
| May | 33 | 1 | 34 | 66 | 3.8 | 49.8 | 46.4 | 14,308 |
| June | 25 | 2 | 27 | 115 | 4.4 | 50.5 | 45.1 | 14,106 |
| July | 124 | 0 | 124 | 48 | 3.8 | 50.4 | 45.8 | 14,527 |
| August | 85 | 21 | 106 | 55 | 3.3 | 50.8 | 45.9 | 14,891 |
| September | 22 | 1 | 23 | 5 | 3.1 | 51.4 | 45.5 | 15,105 |
| October | 21 | 1 | 22 | 14 | 3.1 | 51.2 | 45.7 | 15,285 |
| November | 81 | -48 | 33 | 64 | 3.3 | 52.3 | 44.3 | 15,083 |
| December | -4 | 9 | 5 | 25 | 3.2 | 51.2 | 45.6 | 16,065 |
| **January 1992** | -42 | -3 | -45 | 11 | 3.6 | 50.3 | 46.1 | 15,878 |
| February | -19 | 0 | -19 | 57 | 4.1 | 49.4 | 46.5 | 16,086 |
| March | 292 | -300 | -8 | 2 | 4.2 | 51.6 | 44.2 | 15,870 |
| April | -6 | 2 | -4 | 4 | 4.2 | 51.5 | 44.3 | 15,905 |
| May | -13 | 5 | -8 | 72 | 4.7 | 51.3 | 44.0 | 16,127 |
| June | -22 | 0 | -22 | 150 | 5.7 | 51.5 | 42.8 | 16,264 |
| July | 389 | 152 | 541 | 123 | 3.0 | 53.3 | 43.7 | 16,726 |
| August | -149 | 151 | 2 | -11 | 3.0 | 53.1 | 43.9 | 16,627 |
| September | -200 | 200 | 0 | -10 | 2.9 | 52.0 | 45.1 | 16,809 |
| October | -282 | 282 | 0 | 10 | 2.9 | 49.8 | 47.3 | 16,771 |
| November | -248 | 270 | 22 | -9 | 2.7 | 47.5 | 49.8 | 17,057 |
| December | -500 | 518 | 18 | 4 | 2.6 | 44.7 | 52.7 | 17,305 |
| **January 1993** | -138 | 158 | 20 | 40 | 2.6 | 44.0 | 53.4 | 17,617 |
| February | -253 | 266 | 13 | 2 | 2.6 | 42.9 | 54.5 | 17,811 |
| March | -272 | 335 | 63 | 70 | 2.6 | 40.7 | 56.7 | 18,180 |
| April | -412 | 423 | 11 | 8 | 2.6 | 38.9 | 58.5 | 18,101 |
| May | -206 | 200 | -6 | 1 | 2.5 | 37.2 | 60.3 | 18,387 |
| June | -250 | 210 | -40 | 15 | 2.8 | 36.3 | 60.9 | 18,573 |
| July | -17 | -26 | -43 | 20 | 3.1 | 36.4 | 60.5 | 18,649 |
| August | 0 | 10 | 10 | -12 | 3.0 | 36.0 | 61.0 | 19,183 |
| September | 6 | 1 | 7 | -15 | 2.8 | 36.2 | 61.0 | 19,216 |
| October | -23 | 101 | 78 | -21 | 2.3 | 35.8 | 61.9 | 19,433 |
| November | -426 | 460 | 34 | -22 | 2.0 | 34.0 | 64.0 | 19,032 |
| December | -113 | 158 | 45 | 73 | 2.1 | 32.8 | 65.1 | 19,486 |
| **January 1994** | -1 | 1 | 0 | 14 | 2.1 | 32.3 | 65.6 | 20,105 |
| February | -26 | -25 | -51 | 10 | 2.5 | 32.1 | 65.4 | 19,735 |
| March | -3 | 14 | 11 | 1 | 2.5 | 32.4 | 65.1 | 19,051 |

# Tab C

# EXECUTIVE DIRECTOR'S ADMINISTRATIVE REPORT

DATE: May 31, 1994

TO: Members, State Board of Investment
Members, Investment Advisory Council

FROM: Howard Bicker

## 1. Budget and Travel Reports

A report on the SBI's administrative budget for the period ending April 30, 1994 is in **Attachment A**.

A travel report for the period from February 16, 1994 - May 15, 1994 is included as **Attachment B**.

## 2. Legislative Update

The 1994 Legislature enacted several measures of interest to the SBI. The major provisions of these bills are outlined below.

a. SBI Administrative Bill, Chapter 604

Chapter 604 includes the following provisions which were requested by the SBI:

- The act increases the asset based charge in the Supplemental Investment Fund to 0.4% for the Deferred Compensation Plan and other participating plans, except the Unclassified Plan. The provision is central to SBI and MSRS efforts to restructure the Deferred Compensation Plan.

- The act reestablishes the Board's authority to invest in unrated and below investment grade debt, but with the following restrictions: such investments may not exceed five percent of a fund; the SBI may purchase no more than 50 percent of a single debt issue; and the SBI may purchase no more than 25 percent of the outstanding debt of a given company.

- The act removes international securities from the 35 percent cap placed on alternative investments. This will give the SBI greater flexibility in its future asset allocation decisions.

- The act adds an international account to the Supplemental Investment Fund. This will provide participants with greater investment flexibility tailoring an investment portfolio which meets their own needs.

- The act clarifies SBI's authority to invest in mortgage securities, asset-backed securities, bank collective funds, and real estate investment trusts.

b. Investment Performance Reporting, Chapter 565

Chapter 565 requires the SBI, as well as other public employee pension plans, to report cash flow and return information to the State Auditor on a monthly basis from FY 1988 forward. The bill provides that all expenses for compiling the data must be borne by the Auditor's office.

c. College Plans Administrative Bill, Chapter 508

A provision in Chapter 508 allows the SBI to select up to five financial institutions to provide annuity products for the State University and Community College Systems' plans, the Individual Retirement Account Plan and the Supplemental Retirement Plan. (Currently, there are three different insurance companies that provide products for the plans.)

**3. SBI/IAC Meetings for Calendar 1994**

The quarterly meetings of the SBI/IAC during the remainder of calendar 1994 have been scheduled for:

| SBI | IAC |
|---|---|
| Wednesday, September 7, 1994 | Tuesday, September 6, 1994 |
| Wednesday, December 14, 1994 | Tuesday, December 13, 1994 |

**4. Issues to be Referred to the Deferred Compensation Review Committee**

The SBI has referred issues related to various tax sheltered savings and supplemental retirement plans to the Deferred Compensation Review Committee for study and recommendation. I suggest that the SBI refer the following two new issues to the Committee:

- Selection of a manager for the new guaranteed investment contract (GIC) pool for the Fixed Interest Account in the Supplemental Investment Fund. (The Committee should make a recommendation on this issue at the September 1994 meeting of the SBI.)

- Review of the structure of the Individual Retirement Account Plans (IRAP) and Supplemental Retirement Plans currently administered by the State University and Community College Systems. This will include a Request for Proposal (RFP) process to select vendors to provide annuity products for the Plans. (The Committee should issue the RFP, evaluate responses and recommend specific vendors before the December meeting of the SBI.)

Membership of the Deferred Compensation Review Committee includes a designee of each Board member and the directors of the three statewide retirement systems who are also members of the IAC. For purposes of the GIC manager search, I suggest that the membership of the Committee be expanded to include one or more additional IAC representatives provided they have experience with GIC's and/or GIC pool managers.

**RECOMMENDATION:**

**I recommend that the SBI refer the above issues to the Deferred Compensation Review Committee.**

ATTACHMENT A

STATE BOARD OF INVESTMENT
FISCAL YEAR 1994 ADMINISTRATIVE BUDGET REPORT
GENERAL FUND APPROPRIATION
FISCAL YEAR TO DATE THROUGH APRIL 30,1994

| ITEM | FISCAL YEAR 1994 BUDGET | FISCAL YEAR 1994 EXPENDITURES |
|---|---|---|
| PERSONAL SERVICES | | |
| CLASSIFIED EMPLOYEES | $ 323,000 | $ 260,143 |
| UNCLASSIFIED EMPLOYEES | 1,127,000 | 875,640 |
| SEVERENCE PAYOFF | 0 | 24,990 |
| WORKERS COMPENSATION INSURANCE | 0 | 0 |
| MISCELLANEOUS PAYROLL | 7,000 | 4,287 |
| SUBTOTAL | $ 1,457,000 | $ 1,165,060 |
| EXPENSES & CONTRACTUAL SERVICES | | |
| RENTS & LEASES | 85,000 | 68,292 |
| REPAIRS/ALTERATIONS/MAINTENANCE | 9,000 | 7,862 |
| BONDS AND INSURANCE | 1,000 | 959 |
| PRINTING & BINDING | 18,000 | 12,958 |
| PROFESSIONAL/TECHNICAL SERVICES | 54,000 | 2,944 |
| DATA PROCESSING & SYSTEM SERVICES | 202,500 | 151,875 |
| PURCHASED SERVICES | 35,000 | 24,220 |
| SUBTOTAL | $ 404,500 | $ 269,110 |
| MISCELLANEOUS OPERATING EXPENSES | | |
| COMMUNICATIONS | 27,000 | 19,726 |
| TRAVEL, IN-STATE | 2,000 | 729 |
| TRAVEL, OUT-STATE | 40,000 | 23,552 |
| FEES & OTHER FIXED CHARGES | 8,000 | 7,406 |
| SUBTOTAL | $ 77,000 | $ 51,413 |
| SUPPLIES/MATERIALS/PARTS | 39,500 | 23,057 |
| CAPITAL EQUIPMENT | 35,000 | 13,925 |
| TOTAL GENERAL FUND | $ 2,013,000 | $ 1,522,565 |

**ATTACHMENT B**

## STATE BOARD OF INVESTMENT

### Travel Summary by Date
### February 16, 1994 - May 15, 1994

| Purpose | Name(s) | Destination and Date | Total Cost |
|---|---|---|---|
| **Staff Education**<br>Equitable Real Estate<br>Investor Conference | D. Egeland | Palm Springs CA<br>2/12-16 | $493.50 |
| **Staff Education**<br>Training Seminar<br>for "Proxy Edge" | A. Blauzda | Chicago IL<br>3/9 | $670.78 |
| **Manager Monitoring**<br>**Alternative Investments**<br>T. Rowe Price<br>**Staff Education**<br>Pension Real Estate<br>Association Annual Conference | D. Egeland | Baltimore MD<br>4/4-10 | $1,282.45 |
| **Staff Education**<br>State Street Bank<br>Annual Conference | M. Schmitt | Phoenix AZ<br>4/9-13 | $399.00 |
| **Board Member Travel**<br>Council of Institutional<br>Investors Annual Meeting | M. McGrath | Washington D.C.<br>4/13-17 | $597.70 |
| **Manager Search**<br>**Alternative Investments**<br>CB Commercial,<br>Hellman & Friedman<br>**Manager Monitoring**<br>**Alternative Investments**<br>Inman & Bowman | D. Egeland<br>J. Griebenow | Los Angeles CA<br>San Francisco | $1,965.16 |

# Tab D

## COMMITTEE REPORT

DATE: May 31, 1994

TO: Members, State Board Investment
Members, Investment Advisory Council

FROM: **Stock and Bond Manager Committee**

### Stock and Bond Manager Committee

The Stock and Bond Manager Committee met on May 18, 1994 to discuss the following agenda:

- Review of manager performance for the quarter ending March 31, 1994
- Update on candidates to be included in the Manager Monitoring Program for future active manager searches
- Annual review of investment manager guidelines
- Report from the Passive Manager Review Committee
- Recommendation to use the Lehman Aggregate as the asset class target for the domestic bond program
- Recommendation concerning the management structure of the stock segment of the Assigned Risk Plan

Action by the SBI/IAC is requested on the last three items at this time.

### INFORMATION ITEMS:

**1. Review of Manager Performance**

- Domestic Stock Managers

  For the quarter ended March 31, 1994, the Basic Fund's domestic stock management group outperformed its aggregate benchmark and the Wilshire 5000. (Managers -3.5%; Aggregate Benchmark -3.6%; Wilshire 5000 -3.8%). For the latest year, the current management group slightly underperformed the aggregate benchmark but slightly outperformed the Wilshire 5000 adjusted. (Managers 2.6%; Aggregate Benchmark 2.9%; Wilshire 5000 Adjusted 2.5%). For the latest five years, they have slightly outperformed the aggregate benchmark but slightly underperformed the Wilshire 5000 Adjusted. (Managers 11.7%; Aggregate Benchmark 11.6%; Wilshire 5000 Adjusted 11.8%).

The performance evaluation reports for the domestic stock managers start on **page 69** of this Tab. Manager Commentaries are in **TAB G.**

- Bond Managers

  For the quarter ended December 31, 1993, the domestic bond manager group matched the Salomon Broad Investment Grade (BIG) index (Managers -2.8%; Salomon BIG -2.8%). The current manager group also outperformed for the latest year (Managers 3.6%; Salomon BIG 2.5%) and latest five years (Managers 10.9%; Salomon BIG 10.5%).

The performance evaluation reports for the bond managers start on **page 87** of this Tab. Manager Commentaries are in **TAB G.**

- International Stock Managers

  For the quarter ended March 31, 1994, the international stock manager group underperformed the Morgan Stanley Capital International index of Europe, Australia and the Far East (EAFE) by 1.9% (Managers 1.6%; EAFE 3.5%). For the latest year, the managers underperformed EAFE by 0.5% (Managers 22.0%; EAFE 22.5%). Since inception of the program in October 1992, the international program has underperformed by 0.4% (Managers 19.9%; EAFE 20.3%).

  Staff noted that all of the active managers are underweighted in Japan relative to EAFE and this accounts for the majority of the underperformance in all time periods shown. This was particularly evident during the last quarter when performance of the Japan portion of EAFE was +16.5% while EAFE ex-Japan was -4.7%.

  The performance evaluation reports for the international stock managers start on **page 101** of this Tab. Manager Commentaries are in **TAB G.**

**2. Update on Manager Monitoring Program Candidates**

The SBI has established a Manager Monitoring Program to identify potential candidates for future active manager searches. The candidate firms are intended to serve as the starting point for any active manager search deemed necessary during the coming fiscal year. Up to 10 firms are to be identified for each asset class: domestic stocks, domestic bonds and international stocks.

The SBI added several new managers in each asset class during FY 94. As a result, staff is not prepared to recommend a full list of 10 at this time. The lists shown below should be considered very fluid since staff expect to add and delete names over the coming months. If a formal search is deemed necessary in the coming months, the selection of finalists for interviews will be reviewed with the Stock and Bond Manager Committee.

The recommended list of firms for each asset class is shown below. Please refer to the attached "Manager Fact Sheets" beginning on **page 11** for more information on each firm.

**Domestic Stock Managers:**
Baring America Asset Management
Enhanced Investment Technologies, Inc. (INTECH)
First Pacific Advisors, Inc.
Kemper Asset Management
Pacific Investment Management Company (PIMCO)

**Domestic Bond Managers:**
Blackrock Financial Management
Brinson Partners, Inc.
Criterion Investment Management Company
Durkee Capital Advisors
J.P. Morgan Investment Management, Inc.
Loomis, Sayles & Co.
Pacific Investment Management Company (PIMCO)
Washington Square Advisors

**International Stock Managers:**
Baillie Gifford Overseas Limited
Bank of Ireland Asset Management
Hill Samuel Investment Advisers
J.P. Morgan Investment Management
Lazard Freres Asset Management
Walter Scott & Partners

Staff solicited suggestions from SBI members and designees, IAC members and consultants for the Manager Monitoring Program in early 1994. Some of the suggested firms are included on the above list. Staff are compiling information on the other candidates and would welcome additional suggestions for further research. As noted above, staff expect to bring additional names to the Committee in future quarters.

### 3. Review of Investment Manager Guidelines

The SBI has established guidelines for the external active managers which govern their investment actions. While these guidelines may be changed at any time, they are part of the formal contractual agreement between the SBI and manager. The guidelines address return objectives, benchmarks, authorized investments, performance evaluation, communication and reporting requirements.

Staff and the Committee review the guidelines annually for accuracy and completeness. The changes from the existing guidelines are shown below:

- The domestic stock manager guidelines were modified to allow investment in American Depository Receipts (ADR's) registered on the New York or American Stock Exchanges.

- The guidelines in each asset class were updated to reflect changes in the SBI's policies concerning South Africa and American Home Products. (Each manager was previously notified of these changes immediately after the special meeting of the SBI on October 27, 1993 SBI meeting.

- The guidelines were updated to reflect changes in the SBI's Manager Continuation Policy and the Manager Commentaries. (Each manager was notified of these changes after the September 1993 meeting of the SBI when the revised policy was adopted.)

## ACTION ITEMS:

### 1. Report from the Passive Manager Review Committee

At its March 1994 meeting, the SBI established a Passive Manager Review Committee to consider which combination of passive manager and asset class target can be implemented most efficiently and effectively for the SBI's domestic stock program. The Review Committee was directed to make its recommendations to the Stock and Bond Manager Committee of the IAC before the June 1994 meetings of the SBI/IAC.

The Review Committee was asked to address two issues:

- Evaluate the Wilshire 5000 and the Russell 3000 as the asset class target for the domestic equity program

- Consider the abilities of the SBI's current passive manager (Wilshire Asset Management) and two alternative candidates (Bankers Trust Company and Wells Fargo Nikko Investment Advisers). This was expected to result in either a reaffirmation of Wilshire as the SBI's passive manager or in a recommendation to retain an alternative firm.

The membership of the Review Committee was:

| | |
|---|---|
| Peter Sausen | Governor's designee and Chair of the Committee |
| Christie Eller | Attorney General's designee |
| Jake Manahan | State Treasurer's designee |
| Lisa Rotenberg | State Auditor's designee |
| Elaine Voss | Secretary of State's designee |
| Jim Eckmann | IAC Representative |
| Laurie Hacking | IAC Representative |
| Mike Troutman | IAC Representative |

The Review Committee met on May 10, 1994 and spent considerable time reviewing information prepared by Richards & Tierney (R&T) concerning the operation of the SBI's tilted index fund and excerpts from R&T's presentation materials are attached for your information beginning on **page 57**. R&T's presentation served as the foundation of much of the Committee's discussion with the three firms that were interviewed.

The Review Committee made the following recommendations to the Stock and Bond Manager Committee:

- The SBI should continue to employ the Wilshire 5000 as its asset class target for the domestic equity program. Due to the similarity between the two indices, the Committee could not identify a compelling reason to change to the Russell 3000 at this time.

- The SBI should continue to retain Wilshire Asset Management as its passive manager for the domestic equity program. The Committee believes that Wilshire's results as manager of the tilted index fund are satisfactory given the constraints under which the program has been implemented. In order to improve the ongoing implementation of the tilted index fund, the Committee feels that Wilshire, R&T and staff should work jointly to understand and manage the trade-off between tracking the completeness fund benchmark and incurring the trading costs necessary to do so.

**RECOMMENDATION:**

**The Committee recommends that:**

- **The SBI should continue to utilize the Wilshire 5000 as its asset class target for the domestic equity program.**

- **The SBI should continue to retain Wilshire Asset Management as its passive manager for the domestic stock program. The SBI executive director should be authorized, with assistance from SBI's legal counsel, to update Wilshire's existing contract to reflect current SBI contracting procedures.**

**2. Recommendation to Use the Lehman Aggregate**

The Committee and staff are recommending that the SBI move from the Salomon Broad Investment Grade (BIG) index to the Lehman Aggregate (Aggregate) as its asset class target for the domestic bond program. Background rationale for this recommendation are given below.

*Background*
The bond market is comprised of three broad components:

- issues of the US Treasury and US government agencies (governments)
- debt issued by corporations (corporates)
- mortgages pools and other mortgage-backed securities (mortgages)

Since the SBI's managers invest in all three areas of the market, the market index used as the asset class target for the SBI's domestic bond program should include all three as well.

The SBI began using the Salomon BIG as its asset class target for the domestic bond program in 1984 because it was the only market index that included mortgages as well as governments and corporates at that time. Lehman (then Shearson Lehman) did not add mortgages to its group of published indices until 1986 when it created the Aggregate.

As shown below, the BIG and the Aggregate are nearly identical in composition and return. Therefore, from a policy perspective, either could be used as the asset class target for the bond program:

| | Lehman Aggregate 3/31/94 | Salomon BIG 3/31/94 |
|---|---|---|
| Governments | 53.43% | 51.61% |
| Corporates | 18.08 | 18.86 |
| Mortgages | 28.49 | 29.53 |
| Duration | 4.87 years | 4.91 years |

| | LehmanAggregate | Salomon BIG |
|---|---|---|
| 6/84 - 12/84 | 17.11% | 16.82% |
| 1985 | 22.10 | 22.31 |
| 1986 | 15.26 | 15.44 |
| 1987 | 2.76 | 2.60 |
| 1988 | 7.89 | 7.98 |
| 1989 | 14.53 | 14.44 |
| 1990 | 8.96 | 9.09 |
| 1991 | 16.00 | 15.97 |
| 1992 | 7.40 | 7.59 |
| 1993 | 9.75 | 9.92 |
| 1/94 - 3/94 | -2.87 | -2.81 |
| Annualized | 12.04% | 12.08% |

Staff asked each of the current bond managers to comment on which index they would prefer to use as a performance standard. Due to the similarity between the BIG and the Aggregate, all managers responded that either was representative of their investment approaches and therefore entirely acceptable as a performance benchmark.

***Rationale for Change***

Staff recommended a change from the BIG to the Aggregate because it will enhance the ability to analyze individual manager returns and the results of the entire domestic bond program:

- Lehman provides published data on the Aggregate that is considerably more detailed than Salomon provides on the BIG.

- Currently, staff uses two analytical systems to monitor bond portfolios: BARRA and Bloomberg. Both systems define portfolios in terms of the Aggregate rather than the BIG.

- Software is available from Lehman that would provide more detailed comparative data on the Aggregate than is available through either BARRA or Bloomberg. Such software would facilitate direct analysis of SBI portfolios versus the

Aggregate and its component parts. While staff has explored the possibility of obtaining similar software from Salomon on the BIG, it is not available to the SBI at this time.

The Committee concurs that a move to the Lehman Aggregate would improve the SBI's ability to analyze and monitor portfolio results.

**RECOMMENDATION:**

**The Committee recommends that the SBI utilize the Lehman Aggregate as the asset class target for the domestic bond program beginning July 1, 1994. Further, the investment manager guidelines should be revised accordingly.**

3. **Recommendation Concerning the Management Structure of the Stock Segment of the Assigned Risk Plan.**

At the March 1994 meetings, the Asset Allocation Committee discussed a staff proposal to move the stock segment of the Assigned Risk Plan (ARP) from active to passive management. Staff had concluded that the current active stock manager for the ARP does not provide broad market coverage and therefore exposes the Plan to inappropriate levels of active risk. (Statistical analysis of the manager's returns and the manager's benchmark suggest that the current approach will produce returns that will be ±5 or more percentage points around the S&P 500 on a year-to-year basis. See the Asset Allocation Committee in the March 1994 "Board Folder" for more information.)

After discussing the staff proposal, members were not opposed to passive management but they felt other structures (e.g. less volatile active styles or semi-passive management) may be applicable as well and should be investigated before making a recommendation to the Board:

- **Other Active Managers.** At the suggestion of the Chair of the IAC, staff considered several alternative active managers during the last quarter. Since most of the suggested managers' returns have been quite volatile compared to the S&P 500, the Chair and staff agreed that they were inappropriate for the ARP.

- **Semi-Passive Management.** The Chair and staff concur that semi-passive management would be appropriate for the ARP since volatility would be reduced substantially and broad market coverage would be assured.

The Committee agrees that semi-passive management is appropriate for the stock segment of the ARP over the longer term and believes that a semi-passive manager could be selected for the ARP at the same time the SBI conducts semi-passive manager search for the retirement funds. Until that search is completed, the Committee believes that the stock segment of the ARP should be passively managed in order to eliminate the style bias and reduce the volatility of the portfolio. Nearly all the transactions costs associated with this change will occur with the move from active to passive management; the additional costs associated with a move from passive to semi-passive management at some point in the future should be minimal.

**RECOMMENDATION:**

**The Committee recommends that the SBI approve the following changes in the management structure of the Assigned Risk Plan (ARP):**

- **The stock segment of the ARP should be allocated to passive or semi-passive management rather than active management to eliminate style bias risk and assure market exposure for the Plan's small stock segment.**

- **The stock segment should be passively managed through an internally managed index pool designed to track the performance of the S&P 500 effective July 1, 1994.**

- **The SBI should seek a semi-passive manager for the stock segment of the ARP. Since the SBI expects to conduct a semi-passive stock manager search for the retirement funds within the next year, the selection of a semi-passive manager for the ARP should be coordinated with this effort.**

- **The SBI's executive director should be authorized, with assistance from SBI's legal counsel, to negotiate and execute any necessary contractual amendments with Voyageur Asset Management, the current manager for the ARP, to accommodate these structural changes.**

## DOMESTIC STOCK MANAGER FACT SHEET

**Manager:** **Baring America Asset Management**

**Investment Philosophy and Process**

Barings' philosophy is that over the long term growth stocks outperform the stock market because they believe earnings growth drives stock prices. They also believe that buying growth at an attractive valuation is an equally important determinant of portfolio performance. They focus on medium to large capitalization stocks that show earnings growth and return on equity greater than the S&P 500 and valuations close to the S&P 500.

Barings' investment process consists of three disciplines:

- macroeconomic policy to identify investable themes,
- quantitative measures to narrow the field of opportunities,
- fundamental research to select the best stocks.

Barings' process begins with the macroeconomic policy overview. The Investment Policy Team, composed of all equity and fixed income professionals, meets monthly to discuss events surrounding and shaping the financial markets. The macro economic policy produces six to eight investment themes and projections for various economic variables (e.g. GDP, CPI, interest rates).

The second part of the investment process incorporates a quantitative analysis which uses the macroeconomic policy input to evaluate the attractiveness of various equity sectors. They use five quantitative stock selection models to screen their universe of 1800 stocks to eliminate those that score poorly or do not agree with their policy views. The models are: 1) Earnings Growth; 2) Dividend Growth; 3) Book Value; 4) Earnings Surprise; and 5) Earnings and Price Momentum. Every month each stock is evaluated on each of these five models relative to the 1,800 stock universe and assigned a rating of a 1 (high) to 5 (low). The stocks given 1's and 2's are labeled attractive, 3's and 4's are neutral, and 5's are unattractive. A security must be attractive according to each model in order to be placed on a potential buy list. Any stock with an unattractive (5) rating is not considered further. A list of 60 - 80 stocks that score highest is created for use in the final part of the process.

Barings' analysts and managers use this list of 60 - 80 stocks to focus their fundamental research. A stock must be confirmed by both their "top-down" policy view and fundamental research before it is purchased.

Under Barings' process, they sell a stock when they see an indication that it has become unattractive. A stock may become unattractive as a result of changes in any one of the three disciplines: policy, quantitative, or fundamentals.

## Research

Research efforts focus on each company's financial statements, growth prospects, products, and management capabilities. Barings' research process is characterized by six tenets: internally driven, focused, consistent, team oriented, responsive, and globally oriented.

Barings divides their research into four broad sectors: Consumer, Capital Goods, Industrial, and Finance. Each of their equity managers and analysts has a specific sector responsibility and is in charge of coordinating research and recommending buy and sell decisions for that sector. Barings has nine MIS staff dedicated to the U. S. area who are skilled in their respective areas. They subscribe to several external databases to supplement their internal investment resources. Examples of investment-related external databases to which they subscribe are Bloomberg; First Call; Reuters; Bridge Data; Northfield; BARRA; Zacks; IBES; Compustat; and Holt/Graph. Barings' external sources are consulted only as a means of confirming their internally generated ideas.

## Portfolio Construction

At the time of purchase, holdings will range from 1-4%. No issue exceeds 5% of a portfolio. Barings holds up to 50 issues which they believe provides sufficient diversification of specific risk, but will not dilute the value added in individual stock selection.

Barings groups industries into four major sectors: Consumer, Capital Goods, Industrial and Finance. They typically hold 50% to 200% of the equivalent S&P sector weights, but never more than 50% of the portfolio in any one sector. As growth investors, they generally do not participate in industries which tend to be more value oriented such as Electrical Utilities.

Finally, quantitative models are used to measure clients' portfolio exposure to various economic factors. This provides a final "check" to ensure that the portfolios reflect their "top-down" view.

## Trading

Barings keeps costs down by pooling orders and utilizing program trades.
Barings' traders monitor and review their external brokers on an ongoing basis to assure quality executions. In addition, they spot check prices against the Bloomberg daily weighted average price to assure that best price and execution have been achieved.

## Ownership

Baring America is one of seven investment management subsidiaries of Baring Asset Management. Baring Asset Management is wholly owned by Barings PLC, the parent holding company for all of the Baring Group's interests. Barings is an international group of companies organized into three distinct areas: Baring Asset Management provides financial advisory services, Baring Securities is in the international brokerage business, and Baring Brothers & Co. provides merchant bank services.

Total Number of Equity Portfolio Managers / Analysts: 9

Total Number of Equity Traders: 2

Total Tax-exempt Equity Assets Managed: $ 535.4 MM

Total tax-exempt Domestic Active Equity Assets Managed: $ 535.4 MM

Total number of tax-exempt Domestic Active Equity Accounts: 12

**Three Largest Tax-exempt Active Domestic Equity Accounts:**

Northeast Utilities
Caltech
TRW

## DOMESTIC STOCK MANAGER FACT SHEET

**Manager: Enhanced Investment Technologies, Inc. (INTECH)**

**Investment Philosophy and Process**

INTECH uses a mathematical investment strategy based on stock volatility and correlation. They believe their system is mathematically proven to outperform a passive index in the long term. Their system is not based on market inefficiencies nor does it depend on return forecasts for individual stocks. INTECH's strategy generates excess returns from the relative movement of stock prices, and as long as stock prices continue to vary relative to one another, they believe their process will add value over a large capitalization passive benchmark like the S&P 500.

INTECH believes that for mature, high capitalization stocks the long term growth rate is the same. They claim based on their research that for approximately the largest 1000 market cap stocks, there is no statistical difference in the long term growth rate. The variation in the stocks short term performance is caused entirely by the random nature of the stock price process and not due to different underlying growth rates.

**Research**

INTECH specializes in mathematical and statistical research on stock, portfolio, and market behavior. They use computers to carry out their financial research in a scientific fashion by conducting experiments and testing hypotheses. The primary data base they use is the Center for Research in Securities Prices of the University of Chicago where they obtain all their historical pricing information. INTECH does not perform any traditional fundamental research on individual companies to attempt to discover mispriced securities.

**Portfolio Construction**

INTECH's objective is to generate about 2% average annual excess return over the S&P 500 while controlling risk through several means including assigning a high priority to minimize tracking error in the optimization process, holding beta close to benchmark beta, and weighting stock in the portfolio no more than 1% from the weighting of that stock in the benchmark. The investment process ultimately produces a portfolio with no significant factor bets.

In constructing the portfolio INTECH wants to hold the stocks with the highest volatility. The return volatility of the individual stocks is based on the most recent 365 days of pricing history. Once the portfolio is constructed, they will rebalance, on a weekly basis, the stocks in the portfolio back to their assigned weight until they rerun the optimization program, which is done on a quarterly basis using the updated pricing information. Over the long run they believe this investment process will beat a large cap benchmark because they incrementally sell/buy stocks in the portfolio that are currently performing better/worse than the long term average. Eventually they must perform worse/better so in the long run their growth rate equals the long term average. In essence, it is a buy low/sell high strategy.

The investment process begins with the screening of the S&P 500 to eliminate bankruptcy candidates and securities that do to meet their liquidity requirements. These screen seldom remove more than 30 stocks. A mathematical formula is used to generate optimal portfolio weightings from the universe resulting in a portfolio of 200 to 400 stocks.

**Trading**

INTECH uses an automated system to determine trades based on the execution of programs created by the Chief Financial Officer. This automation minimizes the time frame from the determination of the trade until the submission for execution. Generally, these are small incremental changes to the portfolio. Larger transactions result from the quarterly optimizations. These larger trades are offered to principal brokers in a bidding arrangement. If satisfactory bids are received the lowest bidder is selected for execution. If no bids are satisfactory, the trades will be executed on an agency basis. Trading costs are monitored by INTECH for both internal trades and for trades executed by a broker based on their deviation from the target price established for that trade.

**Ownership**

INTECH is an independent investment advisory subsidiary of The Prudential Insurance Company of America.

Total Number of Equity Portfolio Managers / Analysts: 3

Total Number of Equity Traders: 1

Total Tax-exempt Equity Assets Managed: $ 1,931 MM

Total tax-exempt Domestic Active Equity Assets Managed: $ 1,931 MM

Total number of tax-exempt Domestic Active Equity Accounts: 21

**Three Largest Tax-exempt Active Domestic Equity Accounts:**

| | |
|---|---|
| Prudential Retirement Fund | $ 287.8 MM |
| New York City Teachers Retirement System | $ 267.9 MM |
| Bell Atlantic Corp. | $210.0 MM |

## DOMESTIC STOCK MANAGER FACT SHEET

**Manager:** **First Pacific Advisors, Inc.**

**Investment Philosophy and Process**

First Pacific Advisors' approach does not rely on a forecast of either the market or the economy, but rather on the selection of individual companies and a disciplined judgment of the relative attractiveness of the market valuation of these companies. They feel owning stocks with high return on equity results in high portfolio returns over the long term. They also believe a patient investor, engaging in thorough and broad research, can take advantage of price opportunities or market inefficiencies and acquire securities at attractive prices. First Pacific Advisors believes that investment return is achieved primarily through the long-term ownership of highly profitable companies. However, if the stock price of these companies ultimately reflect the true worth of the investment or exceed it, they can subsequently be sold, with proceeds deployed to more attractive positions.

First Pacific Advisors' investment process begins with databases, such as Compustat, for fundamental balance sheet and operating business characteristics. A broad spectrum of companies are screened to identify a universe of approximately 300 securities that meet the following criteria:

1) high return on equity,
2) high return on assets,
3) liquid, unleveraged balance sheet,
4) consistent record of management,
5) visible and understandable record of success in market sector.

They update the universe monthly for statistical data (e.g. P/E, P/BV) and review it weekly for price.

In the second phase, they focus on internal research. First Pacific analysts study financial reports and meet with company management. They also review Wall Street to validate internal research. Weekly meetings are held to share current and historical data and to review market price action. Portfolio managers perform constant reevaluations of the analysis in order to determine the viability of increasing or maintaining portfolio positions.

The trading staff participates in weekly meetings to provide price and demand information for the team. They monitor price ranges and provide price alerts to portfolio managers.

## Research

First Pacific Advisors generates much of its research internally with selected Wall Street sources used for comparison purpose or for economic or market condition data. Their research process is a combination of both historical and current financial analysis and company visits. They also monitor the universe to determine valuations for both purchase and sale decisions.

## Portfolio Construction

The trading staff monitors both the price and demand of securities on an ongoing basis. The portfolio manager decides the timing of the initial purchase. The portfolio manager performs constant reevaluations of data in order to determine the viability of increasing or maintaining portfolio positions. Securities are purchased for the portfolio when predetermined price levels are reached. Initial positions generally commence at 0.5% of assets and additional purchases are scaled in up to a full position of 2.5 - 3%.

The ongoing weekly review of both price and fundamental data assists in signaling areas of concern. The trading staff monitors predetermined price ranges to determine any necessary price alerts for the portfolio managers. Sales are generated when the marketplace changes a stock's relative valuation and positions are generally scaled back or eliminated in much the same way as they were added but into market strength. First Pacific Advisors also sells a stock when their research reveals deteriorating fundamentals underlying a company's ability to sustain its above average returns.

## Trading

The traders are responsible for monitoring positions held and positions under consideration, relaying market information to the portfolio managers, executing trades, and maintaining records. They have access to all available marketplaces, including after-hours trading and crossing networks. The traders execute large block trades in conducive market conditions, but do not use trading programs or packaged trades. They handle all trades individually and are placed based on best execution.

## Ownership

First Pacific Advisors became an indirect wholly owned subsidiary of United Asset Management Corporation on June 28, 1991. They are one of United Asset Management's 39 independent advisory firms.

Total Number of Equity Portfolio Managers / Analysts: 7

Total Number of Equity Traders: 2

Total Tax-exempt Equity Assets Managed: $ 2,519.2 MM

Total tax-exempt Domestic Active Equity Assets Managed: $ 2,385.2 MM

Total number of tax-exempt Domestic Active Equity Accounts: 42

**Three Largest Tax-exempt Active Domestic Equity Accounts:**

| | |
|---|---|
| Rockwell International | $432.7 MM |
| GTE Corporation | $183.8 MM |
| Xerox Corporation | $171.6 MM |

## DOMESTIC STOCK MANAGER FACT SHEET

**Manager:** **Kemper Asset Management**

### Investment Philosophy and Process

Kemper Asset Management's philosophy is to select stocks of fundamentally strong companies with the potential for accelerated and sustained earnings growth and are undervalued in the stock market. They believe the fundamental, qualitative factors of the company and the current stock price take precedence over other environmental considerations such as economic, political or market factors. They feel the fundamental criteria necessary for considering a stock are management excellence and commitment, above average profitability, leadership position in its business, strong balance sheet, and evidence of sustained unit growth. They look for undervalued stocks by examining the stock's present value using a dividend discount model, the relative price / earnings ratio, and the market's valuation of the company's profitability (relative P/E to relative ROE). Using this process, they believe they purchase growth at an attractive price.

Kemper Asset Management's investment decisions are made by an investment committee comprised of the Chief Investment Officer, Portfolio Managers, and the Director of Research. An approved stock list is developed through this group. The process begins when an analyst evaluates a new stock "idea" through fundamental analysis that includes a forecast of earnings, cash flow, application of the valuation discipline, and the identification of the fundamentals that need to be monitored to remain on its critical path to success. The critical path to success for a company outlines the criteria that must be maintained for earnings to be realized such as leadership, technology innovation, regulatory issues, etc. Once approved by the investment committee, each idea is weighted for its attractiveness based on return potential.

The approved ideas are placed on one of two lists, either the Core List for Kemper's best stock ideas, or the Supplemental List for the stocks that do not qualify for the Core List due to current price, fundamental changes, or insufficient committee consensus. All portfolio managers are required to have at least 85% of their assets invested in Core stocks, while the remaining 15% can come from the Supplemental List. They delete stocks from the Core List when less than four portfolio managers own it. They sell a stock when it is within 5% of its target price, or if it violates the critical path to success criteria.

## Research

Kemper Asset Management generates 80% of its research internally, while 20% comes from external research such as company management, industry sources, and brokerage firms. Initially the analysts screen for the following:

- perceived industry and company changes
- relative price / earnings ratio relative to the S&P 500
- relative P / E / ROE
- current price as a percent of projected present value
- current price as a percent of price target
- cash flow as percent of market value

After identifying potential equity opportunities, one of their 26 analysts conducts a detailed fundamental analysis on the stock. Kemper analysts make over 300 on-site visits and have over 200 companies visit their offices each year. The analysts develop detailed reports that provide two year projections of earning, cash flow, balance sheet analysis, evaluation of positive and negative occurrences and management assessment. The analysts also provide the investment committee with an outline of the factors necessary for a company to remain on its critical path to success.

## Trading

Kemper Asset Management has direct lines to 50 major brokers that enable traders to choose the best broker for a given order. The traders monitor the brokers through a quantitative trading cost evaluation system and a qualitative evaluation. Kemper's traders attend a daily investment meeting to review open orders, to provide input from brokers, and to develop an understanding of what stocks the portfolio managers are currently researching. Kemper's systems allow portfolio managers to enter purchase and sale orders themselves, and it automatically combines orders for the same security.

If there are difficulties with a particular order, the trader brings it to the attention of the portfolio manager so that an agreed course of action can be taken. All equity investment personnel receive a daily report of stocks purchased or sold the previous day. They meet daily to discuss the reasons for the transactions and the prices obtained.

**Ownership**

Kemper Asset Management is a wholly owned subsidiary of Kemper Financial Services, Inc. GE Capital is currently seeking to acquire Kemper Corporation.

Total Number of Equity Portfolio Managers / Analysts: 36

Total Number of Equity Traders: 4

Total Tax-exempt Equity Assets Managed: $ 1,581 MM

Total tax-exempt Domestic Active Equity Assets Managed: $ 936 MM

Total number of tax-exempt Domestic Active Equity Accounts: 15

**Three Largest Tax-exempt Active Domestic Equity Accounts:**

| | |
|---|---|
| Kemper National | $ 193.2 MM |
| Baxter International Inc. | $ 120.8 MM |
| Rochester Gas & Electric | $ 105.7 MM |

## DOMESTIC STOCK MANAGER FACT SHEET

**Manager: Pacific Investment Management Company**

### Investment Philosophy and Process

Pacific Investment Management Company's (PIMCO) investment philosophy is based on the principle that stock index futures, when used as a non-leveraged vehicle for obtaining long-term equity exposure, offer an attractive means for enhancing equity market returns. They believe that stock index futures contracts are typically used as a means to gain market exposure over short, uncertain time horizons. Thus, the contracts must be backed with relatively risk-free debt securities which provide nearly perfect liquidity, since the entire portfolio could be liquidated on a moment's notice. This is why, in practice, the computation of the fair value of a stock index futures contract uses a riskless T-bill rate with a maturity equal to the expiration date of the futures contract. By maintaining constant exposure, PIMCO believes their skill as a fixed income manager gives them an advantage to seek out higher returns on the high quality fixed income securities they use to back the futures contracts. They actively manage the duration of the fixed income portfolio within a range of zero to one year with six months being a neutral duration target. They feel the six month neutral point represents a very efficient point on the yield curve.

PIMCO's investment process involves going long S&P 500 index futures in an amount sufficient to cover 100% of the value of a client's investment. This requires an initial margin deposit in the form of T-bills equal to approximately 5% of the value of the investment. They use the remaining 95% to construct a portfolio of high quality (a minimum quality per issue of Baa) fixed income securities.

They use the same process for determining the duration in the equity portfolios as they use in all their other fixed income accounts. The process to construct a fixed income portfolio begins with an annual, secular economics forum in which all investment professionals participate to establish a duration target for the portfolio. During the forum internal and external professionals present information on long-term economic, geopolitical, fiscal, monetary, and demographic trends. On a quarterly basis, they define the exact duration target during an economics forecasting session. This session focuses on near-term outlook for GDP, inflation, business, cycle position, and Federal Reserve policy. The portfolio's strategy is carried out by a fifteen member team by consensus.

## Research

PIMCO relies primarily on in-house research for decision making. They maintain several databases using data provided by the Bureau of Economic Analysis, the Commerce Department, the Congressional Budget Office, the Federal Reserve Board, the OECD, and others. They also have developed and maintain over 30 computer models and programs to evaluate the treasury coupon and strip curves, options embedded in various mortgage and corporate securities, and financial futures. PIMCO also performs credit analysis internally on every issue held in the portfolio. They focus on those issues that show improving credit profiles and the potential for upgrades by the rating agencies giving them greater appreciation potential.

## Portfolio Construction

PIMCO's 15 member fixed income portfolio group works on a team or consensus basis to develop and implement portfolio strategy. The group's structure can best be described as a hub and spoke system, with four senior generalist portfolio managers being the hub, receiving input from several specialists (governments, corporates, mortgages, derivatives, international, etc.). The generalists have responsibility for implementing strategy in specific portfolios, while the specialists assist them with expertise and execution in their respective areas.

## Trading

The portfolio mangers conduct all the trading and have constant access to live trading information through Telerate, Bloomberg, Quotron, etc. They also have direct lines to all the major dealers. PIMCO executes all trades on a best efforts basis and maintains relationships with those brokers who are able to make the best markets.

The portfolio management team monitors the trading and execution efficiency.
They attempt to use PIMCO's size in the fixed income markets as an advantage in demanding tight markets from the dealer community. PIMCO also believes they have the ability to operate rapid-fire competitive bidding processes for trades when appropriate.

## Ownership

Pacific Investment Management Company (PIMCO) is technically owned by Pacific Mutual, but key PIMCO professionals are contractually entitled to approximately 60% of the firm's after tax profits.

Total Number of Equity Portfolio Managers / Analysts: 5

Total Number of Equity Traders: 0 (Executed by portfolio manager)

Total Tax-exempt Equity Assets Managed: $ 4,114 MM

Total tax-exempt Domestic Active Equity Assets Managed: $ 4,104 MM

Total number of tax-exempt Domestic Active Equity Accounts: 15

**Three Largest Tax-exempt Active Domestic Equity Accounts:**

| | |
|---|---|
| Illinois Teachers Retirement System | $ 501 MM |
| Western Conference of Teamsters | $ 388 MM |
| BellSouth Corportation | $ 357 MM |

## BOND MANAGER FACT SHEET

**Manager:** ***Blackrock Financial Management (BFM)***

**Investment Approach**

Blackrock is a relatively new firm formed in 1988 with several experienced Wall Street professionals. The firm has had rapid growth, now managing over $12 billion in fixed income assets. BFM's investment philosophy is centered around four fundamental principles. They are 1) duration targeting, 2) relative value sector and security selection, 3) rigorous quantitative evaluation of securities and portfolios, and 4) strong credit quality bias to portfolio structure.

The portfolios managed against a broad investment grade index are managed by examining macroeconomic trends, supply/demand analysis, yield curve structure and trends, volatility and convexity analyses, and security specific option adjusted spread analysis. The target duration is normally equal to the benchmark duration. Portfolio duration is then kept within a narrow band, usually +/-20% of the target benchmark.

BFM's primary focus for adding value is sector and individual security selection. Sector allocation decisions are made using analysis of both fundamental and technical factors affecting relative value among sectors. Using these analyses, the firm may aggressively over or underweight particular sectors. Over time, BFM has been overweighted in the mortgage sector and underweighted in the corporate sector of the market.

Security selection decisions are generally made by the portfolio management team based upon internally generated research. The primary focus of this research is option adjusted spread analysis, utilizing proprietary software and analytics. BFM's analytic systems are an integral part of the decision-making process, as the portfolio managers use proprietary state-of-the art technology to compare securities and to understand the impact of buy/sell decisions to the overall portfolio. The firm continually monitors option adjusted spread and effective duration on the securities it owns as mortgage securities and callable corporate securities are subject to value changes due to frequent fluctuations in interest rates. BFM also adds value in security selection by utilizing securities such as CMO's and other structured mortgage securities and mortgage derivatives that have favorable risk/reward characteristics.

**Ownership**

BFM is a limited partnership which is 65% owned by the firm's 17 partners, all of whom are employees of the firm. The Blackstone Group, a private investment bank, owns the remaining 35%. Blackstone Group plays no role in the management of BFM or its daily operations.

**Assets Under Management**

| | | |
|---|---|---|
| Total fixed income assets managed: | $23.0 billion | |
| Total fixed income assets managed in the core fixed income style: | $7.6 billion | |
| Total number of fixed income accounts managed for this style: | 15 | |
| Three largest tax-exempt accounts managed in this style: | **Account Type** | **Market Value** |
| | The Annuity Board of the Southern Baptist Convention | $330 million |
| | Honeywell | $213 million |
| | State of Florida Treasury | $195 million |

## BOND MANAGER FACT SHEET

**Manager:** ***Brinson Partners, Inc.***

**Investment Approach**

Brinson uses a highly quantitative, disciplined process, with an emphasis on risk management. They add value by actively managing interest rate sensitivity, yield curve positioning, sector exposure and individual security selection. Each of these four factors is weighted equally in the construction of the optimal client portfolio. In addition to managing U.S. portfolios, Brinson has international portfolio construction expertise.

Brinson adds value first by actively managing interest rate risk. The process begins with determining an equilibrium asset return. This is the long-term normal market return required of an asset to compensate the investor for its risk. The factors that go into determining this return are the real risk free rate, the inflation premium and the risk premium for a particular asset. Once the equilibrium asset return, or required rate is calculated, it is compared to current market yields. This drives the duration decision. The firm does not take large bets, but will adjust the portfolio for perceived differences in required returns and those observed in the market. Portfolio duration averages 4.5 years.

Next, the firm adds value by incorporating expected changes in the shape of the yield curve. In their analysis, the "normal" yield curve is plotted against the current yield curve. This helps uncover relative over/under valuations along sections of the curve.

Sector strategies are implemented based on a comparison of current market yield spreads with estimates of equilibrium yield spreads for particular segments of the U.S. bond market. Equilibrium yield spreads take into account credit risks, the value of imbedded options, mortgage prepayments, etc. Over the past five years, Brinson has remained within 5 percent of the index in each of the various sectors.

Having established the overall maturity, yield curve and sector exposures, the portfolio manager searches for individual bonds which will give these macro-characteristics at the lowest cost. In-house credit research is an important element within the corporate bond sector, and analysis of pre-payments and option adjusted spreads are crucial to the mortgage security selection.

**Ownership**

Over one-half of the employees own 76% of the firm. In addition to the majority ownership by the firm's investment professionals, minority interests are held by Hellman & Friedman Capital Partners and Yasuda Fire and Marine Insurance Co., Ltd.

**Assets Under Management**

| | | |
|---|---|---|
| Total fixed income assets managed: | $9.1 billion | |
| Total fixed income assets managed in the core fixed income style: | $3.3 billion | |
| Total number of fixed income accounts managed for this style: | 65 | |

Three largest tax-exempt accounts managed in this style:

| Account Type | Market Value |
|---|---|
| Corporate | $454 million |
| Union | $295 million |
| Public | $280 million |

# BOND MANAGER FACT SHEET

**Manager:** ***Criterion Investment Management Company***

## Investment Approach

Criterion's investment philosophy emphasizes interest rate decisions, selection of the appropriate part(s) of the yield curve, shifts among sectors of the bond market and the selection of individual issues. The investment process is highly quantitative and focuses on research and analysis of monetary, economic, technical, social, political and international conditions and their effect on the markets. Although the firm invests in all sectors of the market, it specializes in mortgage securities.

Within the client guidelines and the firm's interest rate forecast, portfolio structure is controlled by volatility. Volatility is defined as the numerical measure of the future change in total return of a bond or a portfolio of bonds for a change in the level of interest rates over a specific time period. The firm feels that volatility is a superior measure to duration for measuring the risk/return characteristics.

An internally developed, proprietary computerized management system is used to optimize portfolio structure decisions for maturity, sectors, coupon and quality to maximize return/risk for a desired level of interest rate exposure, as measured by volatility. portfolio volatility is adjusted to reflect the interest rate outlook and is set relative to the portfolio benchmark. A portfolio volatility target greater than the benchmark volatility indicates they expect interest rates to decline, while a forecast for rising interest rates would result in a portfolio volatility lower than the benchmark volatility.

To determine the optimal positioning of the portfolio along the yield curve, the firm divides the yield curve into three maturity segments. Each of these segments exists around a group of natural investors who help establish a unique supply and demand situation for that maturity range. Criterion's system measures the portfolio's exposure to a change in the shape of any or all of these three segments.

The decision to move from one sector to another is a function of relative values and future expected changes in relative values between sectors. relative value is determined by the level of yield spreads between sectors, the cash flow or repayment features of sectors, and the supply/demand and quality attributes of sectors. The firm's internally developed analytical system enables them to measure the relative amount of widening and narrowing of spreads between sectors.

## Ownership

Criterion Investment Management Company is owned by Transamerica Corporation.

**Assets Under Management**

| | **12/31/93** |
|---|---|
| Total fixed income assets managed: | $10,588 million |
| Total fixed income assets managed in the core fixed income style: | $8,100 million |
| Total number of fixed income accounts managed for this style: | 68 |

Three largest tax-exempt accounts managed in this style:

| **Account Type** | **Market Value** |
|---|---|
| Ill. Municipal Retirement Fund | $721 million |
| Mississippi Public Employee Retirement Fund | $708 million |
| Nevada Public Employees Retirement Fund | $625 million |

## BOND MANAGER FACT SHEET

**Manager:** ***Durkee Capital Advisors***

### Investment Approach

Durkee Capital Advisors was founded in 1989 to manage fixed income securities using a variety of quantitative investment techniques. These techniques were developed and refined by the founding partner, Edward Durkee, prior to establishing the firm.

The firm's investment style is termed "Reactive Allocation." The objective of Reactive Allocation is to earn excess returns over a given benchmark index. Portfolios are indexed during periods of price dormancy, and adjusted to exploit price trends in up or down markets through security selection and dynamic trading. Their approach eliminates any type of forecasting or "betting." It makes small changes to portfolios purely in reaction to market events that have already occurred. These changes alter duration slightly and take advantage of the convexity effect.

Reactive Allocation is an objective, structured, quantitative strategy which rejects any type of anticipation. It relies solely on observed price movements to determine portfolio adjustment. It assumes future price changes are unknowable; it simply adjusts to such changes as they happen. Capital is preserved by automatically shortening maturities during periods of declining prices. the strategy is adaptable to managing domestic or international portfolios of short, intermediate or long duration.

Portfolio quality is primary and approximately 75% of each portfolio is comprised of U.S. Treasury and Agency bonds. Any corporate securities used are restricted to issues ratted AA or better. They don't purchase callable or redeemable securities. While many managers with such high quality portfolios have difficulty competing for overall return, Durkee Capital attempts to combine safety with performance. Their standard deviation is very close to that of the Lehman Government/Corporate Bond Index. Durkee reports that their Reactive Allocation has outperformed the Lehman Index annually since inception (gross of fees).

### Ownership

Durkee Capital is 50% employee owned and 50% owned by external, passive investors previously associated with Chicago Research & Trading.

**Assets Under Management**

| | | |
|---|---|---|
| Total fixed income assets managed : | $645 million | |
| Total fixed income assets managed in the core fixed income style: | $605 million | |
| Total number of fixed income accounts managed for the style: | 13 | |
| Three largest tax-exempt accounts managed in this style: | **Account Type** | **Market Value** |
| | San Diego Employees' Retirement System | $118 million |
| | Building Laborers' Pension Fund | $52 million |
| | Minneapolis Employees' Retirement System | $47 million |

## BOND MANAGER FACT SHEET

**Manager:** ***J.P. Morgan Investment Management, Inc.***

**Investment Approach**

J.P. Morgan's active fixed income investment style seeks to maximize yield as a reliable source of excess return, and add only moderate additional value from inherently riskier duration decisions. The firm makes only modest duration bets, emphasizes rigorous credit analysis, quantitative research, active sector and security selection and well-executed trading as consistent sources of value.

In order to make the duration decision, several factors that affect interest rates are analyzed. On a monthly basis, interest rate and volatility forecasts are developed for optimistic, pessimistic and most likely economic scenarios. In addition, the likelihood of non-parallel shifts in the yield curve are incorporated in the analysis. Having assessed these factors, the firm positions the maturity and structure of the portfolio. Portfolio duration is rarely greater than +/- one year of the client benchmark portfolio.

Sector allocation and security selection are also important aspects of the investment process. Morgan analyzes the current spreads versus historical norms as well as utilizes market and credit research to assess fair value and the likelihood of sector spreads widening or narrowing. Securities are selected by the portfolio managers with substantial input coming from the trading desk and fixed income research area.

To achieve outperformance and diversify risk in the actively managed fixed income accounts, Morgan participates in the entire fixed income market. They complement the use of traditional instruments by investing in corporate private placements, directly placed mortgages, non-dollar securities, financial futures, and bond options. The firm's research shows that using these extended markets in conjunction with the traditional securities provides higher returns, improves creditworthiness and reduces risk in actively managed portfolios. In general, they have been overweighted in corporates and mortgages versus the aggregate benchmark over time.

**Ownership**

J.P. Morgan Investment management is a wholly-owned subsidiary of JP. Morgan & Company, Inc., a bank holding company which also owns Morgan Guaranty Trust Company, J.P. Morgan Securities, Inc. and J.P. Morgan Futures.

**Assets Under Management**

Total fixed income assets managed: $51,540 million

Total fixed income assets managed in the core fixed income style: $16,294 million

Total number of fixed income accounts managed for this style: 160

Three largest tax-exempt accounts managed in this style:

| Client Type | Market Value |
|---|---|
| Corporate Pension | $1,932 million |
| Public Pension | $861 million |
| Corporate Pension | $673 million |

# BOND MANAGER FACT SHEET

**Manager:** *Loomis, Sayles & Co.*

## Investment Approach

Loomis Sayles' investment grade fixed income portfolios offer above average yield as well as capital gains potential by focusing on discount, investment grade, corporate bonds. By leveraging off the firm's significant commitment to credit research, their investment grade style primarily seeks to add value through "bond picking" in the BBB and A markets. Additionally, they attempt to add value by building structural advantages into their portfolios which include: 1) yield advantage, 2) credit bias, and 3) call protection. The common objective for investment grade accounts is to deliver superior performance while limiting portfolio volatility.

By accepting the credit risk of corporate bonds, Loomis' investment grade portfolios attempt to capture the yield advantage of BBB and single A issuers. In a low turnover portfolio that is well call protected, they will attempt to lock-in yield premiums which over time materialize as total return. Loomis' in-house credit research capability seeks to go beyond the major credit agencies to identify and anticipate likely credit movements. By constructing portfolios with credit bias in mind, they seek to participate in upgrades and avoid downgrades.

Loomis monitors yield spreads over like maturity Treasury bonds to evaluate sectors, industries and issues on their current relative value. Using this information, they will overweight industries and sectors they perceive offer the most value. Loomis does limit investment in a single issuer to five percent of the portfolio.

Loomis does not make significant duration moves. Portfolio durations are adjusted gradually and are moderated by their normal bias for intermediate and long term securities.

## Ownership

Loomis, Sayles is a wholly owned, but autonomous subsidiary of New England Investment Companies, L.P. New England Investment Companies, L.P. is the parent to nine other investment firms. Assets are managed in ten regional offices around the country.

**Assets Under Management**

| | | |
|---|---|---|
| Total fixed income assets managed : | $17.795 billion | |
| Total fixed income assets managed in the core fixed income style: | $3.051 billion | |
| Total number of fixed income accounts managed for the style: | 34 | |
| Three largest tax-exempt accounts managed in this style: | **Account Type** | **Market Value** |
| | Arkansas Public Employees' Retirement System | $534.9 million |
| | Massachusetts Teachers Retirement System | $327.6 million |
| | Iowa Public Employees' Retirement System | $279.5 million |

## BOND MANAGER FACT SHEET

**Manager:** *Pacific Investment Management Company*

### Investment Approach

Pacific Investment Management Company (PIMCO) fixed income philosophy includes three key principles: 1. Portfolio strategy is driven by long term trends; 2. PIMCO avoids extreme swings in duration; 3. PIMCO adds value through sector, coupon and quality selection. PIMCO also uses futures and options extensively.

PIMCO emphasizes long term trends (three to five years) recognizing that demographics, political factors, and structural changes in the domestic and international economy exert sustained influences on interest rates. Thus, PIMCO annually updates their interest rate outlook and determines their duration range for the portfolio. The duration is never extreme and normally ranges between three and six years.

PIMCO uses all sectors of the bond market including hedged foreign bonds. They make significant sector shifts depending on changes in relative valuations and spreads. PIMCO's internally developed software assists in sector and individual security analysis.

PIMCO's average portfolio quality varies from A to Aaa depending on their outlook for rates and quality spreads. PIMCO performs thorough credit analysis on all holdings, enabling them to distinguish more accurately between levels of quality published by the outside rating services.

### Ownership

Pacific Mutual, a mutual life insurance company, owns PIMCO but constitutes only one third of the membership of PIMCO's Board of Directors. The managing directors from PIMCO control the majority of the votes and the Principals of the firm have significant equity participation in PIMCO's profits.

## Assets Under Management

| | | |
|---|---|---|
| Total fixed income assets managed : | $49.116 billion | |
| Total fixed income assets managed in the core fixed income style: | $32.776 billion | |
| Total number of fixed income accounts managed for the style: | 140 | |
| Three largest tax-exempt accounts managed in this style: | **Account Type** | **Market Value** |
| | Public Plan | $1.623 billion |
| | Public Plan | $1.182 billion |
| | Public Plan | $ .929 billion |

## BOND MANAGER FACT SHEET

**Manager:** ***Washington Square Advisors***

**Investment Approach**

Washington Square Advisers (WSA) believes that fixed-income corporate and mortgage-backed securities offer attractive value relative to Treasury bonds over an economic cycle and that credit and options risk analysis provides greater value than interest rate forecasting. WSA's fixed-income investment approach is yield oriented and relies on thorough analysis of credit and options risk. WSA seeks out relative value within the fixed-income market and favors intermediate maturities. WSA emphasizes low portfolio turnover, capitalizing on the power of coupon compounding by remaining fully invested.

A typical WSA portfolio consists of 40-60 issues. WSA primarily owns intermediate maturity securities within a five to twelve year range. WSA keeps the portfolio duration within four to seven years and overweights mortgages and corporates in the portfolio. WSA's investment process assesses political and economic trends and investment market themes in identifying and focusing on undervalued sectors, issuers, and issues. This is a collaborative process between WSA's portfolio managers, analysts, traders and economic adviser.

**Ownership**

WSA is the fixed-income portfolio management division of Washington Square Capital, Inc., which is a wholly-owned subsidiary of The NWNL Companies, Inc.

## Assets Under Management

| | | |
|---|---|---|
| Total fixed income assets managed : | $5.455 billion | |
| Total fixed income assets managed in the core fixed income style: | $5.455 billion | |
| Total number of fixed income accounts managed for the style: | 15 | |
| Three largest tax-exempt accounts managed in this style: | **Account Type** | **Market Value** |
| | Minneapolis Employees' Retirement System | $34.3 million |
| | Northwestern National Life Pension Plan | $11.3 million |
| | Mississippi Baptist Foundation | $10.0 million |

**Manager:** ***Baillie Gifford Overseas Limited***

**General Style:** Top-down/Bottom-Up with greater emphasis on Bottom-Up
**Orientation:** Quality/Value

**Philosophy**:
There are three central themes to the firm's investment philosophy. First is fundamental style. They place heavy emphasis on doing their own fundamental research. Second is a medium term time horizon. They aim to pick stocks which will outperform over the medium term, which they define as 3-5 years. The third theme is quality, then value. When picking stocks, they first look for quality companies that have good growth prospects going forward. Once they have identified quality companies, they determine if these companies are selling at sensible prices.

**Portfolio Management**:
Baillie Gifford's investment process is based on a team structure. They have an Investment Policy Committee which determines the overall policy and strategic moves for the portfolio. This policy includes country guidelines and currency selection.

Next they have a Pension Fund Team which interprets the strategic decisions made by the Investment Policy Committee for each client's portfolio. The team determines the appropriate regional weightings for portfolios given the client's investment guidelines and restrictions.

Once precise regional weightings have been agreed upon, it is the responsibility of the different geographical teams to determine individual country weightings and to select stocks within countries based on the fundamental research carried out by members of the geographical teams. The teams are organized according to Continental Europe, U.K., Far East and North America.

Stock picking has been the focus of the investment process, but Baillie Gifford also pays attention to the macroeconomic prospects for the different regions and countries in which they invest.

**Ownership**:
Baillie Gifford is an Edinburgh-based partnership. It was founded in 1908 and employs 180 people.

**Manager:** *Bank of Ireland Asset Management (BIAM)*

**General Style:** Top-Down/Bottom-Up with greater emphasis on Bottom-Up
**Orientation:** Thematic/Value

**Philosophy**:
BIAM's investment philosophy is based on the belief that value arises from the ability of assets to generate income either now or in the future. Their philosophy is fundamental and value-driven. It is also based on the premise that basic economic events, which are thematic in nature, and which may transcend political and geopolitical boundaries, provide the best opportunities for effective investment selection. Historically, BIAM has taken very large "bets" relative to EAFE.

**Portfolio Management**:
They key decision making areas in the investment process are:

*Thematic Selection* -- Their approach uses economic and market analysis to identify themes and to specify investment selection criteria which are then consistently applied in a bottom-up stock selection process. The thematic weightings are set by reference to the relative attractiveness of the various themes represented in their portfolios at any time. This is done by the Investment Strategy Committee.

*Stock Selection* -- Individual stock selection is the responsibility of the Analysis Team. This is done after the appropriate themes have been selected. Fundamentally undervalued stocks are identified by a range of characteristics, including dividend yield, consistency of earnings growth and cash flow, financial strength and liquidity. Valuation comparisons are made on a global basis with other companies in similar sectors. BIAM typically focuses on larger capitalization companies than many other managers.

*Portfolio Construction* -- Portfolio managers construct client portfolios from selected stock lists screened according to client guidelines. When constructing portfolios, portfolio managers do not have personal discretion in their activities but operate solely within a team structure, thus ensuring similarity between accounts. The portfolios tend towards larger capitalized growth oriented companies with a proven track record of earnings growth. They tend to substantially overweight these companies relative to their market weighting.

**Ownership**:
Bank of Ireland Asset Management (BIAM) is a wholly owned subsidiary of the Bank of Ireland. BIAM was opened in 1988 and manages assets for U.S.-based clients. The Bank of Ireland manages over $6 billion in global securities.

**Manager:** *Hill Samuel Investment Advisers (HSIA)*

**General Style:** Top-Down/Bottom-Up with greater emphasis on Top-Down
**Orientation:** Value

**Philosophy**:
The cornerstone of Hill Samuel's investment philosophy is "winning by not losing." HSIA attempts to outperform in down markets and keep pace with the market during rising markets, in order to achieve overall outperformance. They believe this provides three benefits to their clients: 1) consistent above-average performance, 2) superior performance while taking less than market risk, and 3) low volatility relative to other managers and EAFE.

**Portfolio Management**:
HSIA evaluates each market and security on both a long-term and short-term basis. They believe the single most important ingredient for success is to "know your companies". The firm relies very little on outside resources for research. They have four regional research groups which are headquartered in London: European Equity Group, Far Eastern Equity Group, North American Equity Group and the Fixed Income and Currency Group.

The stock selection process is driven by fundamentals. The bottom-up process starts with security research. They do "screening in" to find stocks which are interesting based on dividend yield, P/E, B/P and cash flow/price ratios. The analysts then evaluate these companies and make recommendations on attractive stocks. To get on the firm's approved list, the stock must first be approved by the Regional Research Committee. Once it passes this, it must be approved by the Investment Committee, which makes the ultimate decision.

The Investment Committee makes the country allocation. They use a geographical model for guidelines in country weightings. This model is the result of an optimizer. They use their judgment to make country allocations based on the model and other factors, such as world economic factors. Different models are used for different types of clients, based on their particular restrictions.

Portfolio managers are responsible for building the portfolios. They take the country weights established by the Investment Committee and choose stocks from the approved list. Each manager is able to deviate ± 2% from the established country guidelines.

**Ownership**:
HSIA is a London-based, SEC registered firm established in 1982. HSIA is part of the Hill Samuel Investment Management Group (HSIMG). HSIMG is owned by the Trustee Savings Bank (TSB) Group plc. Hill Samuel purchased Investment Advisers in 1986.

**Manager**: *J.P. Morgan Investment Management (JPMIM)*

**General Style:** Top-Down/Bottom-Up with greater emphasis on Bottom-Up
**Orientation:** Value

**Philosophy**:
JPMIM uses a very risk controlled investment approach, attempting to outperform EAFE by 300 basis points per annum in both up and down markets. JPMIM's investment philosophy is that fundamental research can establish fair values for assets. These fair values may differ from market prices, but market prices will eventually move toward these fair values. They attempt to capitalize on those situations where the market price and fair value deviate.

**Portfolio Management**:
The first step in the investment process is the country allocation decision. This involves first making a long-term economic assessment about the various countries. These assumptions are used as input into a country allocation model. The model looks at the dividend discount rate (DDR) for a country and compares that to alternative investments (such as the long bond yield) to determine a risk premium. The model compares this current risk premium with an historical average to determine the current risk premium deviation. If this deviation is positive, the market is undervalued. The firm follows this process for each country and ranks them from the most undervalued to the most overvalued. The Strategy Committee combines the risk premium analysis with subjective assessment to determine portfolio over/underweightings.

The next step is the stock selection process. JPMIM uses regional analysts to perform this. These analysts are also industry experts. They generate earnings and cash flow projections as the chief inputs into their valuation model. Every stock in their research universe is categorized by country into an industry sector. Stocks are placed into a quintile ranking, based upon their dividend discount rates, with the most undervalued stocks in the first quintile and the most overvalued stocks in the lower quintile.

Each portfolio manager, who is a country specialist, works closely with the industry analysts to select the most undervalued stocks within each sector, primarily purchasing stocks ranked in the first quintile. In the event a stock's DDR declines, due to an increase in price or a deterioration of long-term fundamentals, the country specialist may decide to sell the security. Stocks typically become candidates for sale when they drop to the third quintile within their industry sector.

**Ownership**:
JPMIM is owned by J.P. Morgan & Company.

**Manager:** *Lazard Frères Asset Management (LFAM)*

**General Style:** Primarily Bottom-Up
**Orientation:** Value

**Philosophy:**
Lazard employs a systematic, disciplined, bottom-up approach to international investing. The firm takes a value approach to investing. They like "cheap stocks in cheap markets". Historically, Lazard has taken very large "bets" relative to EAFE.

**Portfolio Management:**
The portfolio management process is done in four stages. The first stage is database screening. They begin with a universe of 4,500 international companies. They screen to find companies which are undervalued versus the local index and the world index. This eliminates approximately 80% of the companies. They also will look elsewhere for companies which may have been missed by the screening process due to accounting distortions, but actually qualify for their universe. They develop a value indicator for each stock to see how much it is undervalued relative to the market.

The next step is the accounting validation process. This is Lazard's check to see if financial productivity and pricing is accurately stated. They determine if the numbers they see initially are the true numbers and focus a lot of effort on analyzing the differences. They have one person employed internally to keep them up-to-date on international accounting conventions.

The third stage is fundamental analysis. They perform research to determine if the returns can be sustained and to determine an outlook for the company.

The final stage is portfolio construction. All portfolio managers are also analysts. Each analyst/manager originating an idea presents it to the Investment Team to determine if the stock should go in the portfolio. The Investment Team makes the final decision.

Country allocation is an outgrowth of stock selection and is looked at from a risk control perspective. Lazard emphasizes undervalued markets and takes into consideration the economic outlook for a market. They develop a value indicator, similar to those developed for the stocks, and determine which countries are undervalued or overvalued relative to the world index. They set their country exposures from this and can deviate quite dramatically from the EAFE index.

**Ownership:**
Lazard Frères & Co. is a partnership which was founded in 1848. Lazard Frères Asset Management was founded in 1970 as a separate entity. LFAM began managing international equities in 1984.

**Manager:** ***Walter Scott & Partners***

**General Style:** Primarily Bottom-Up
**Orientation:** Growth

**Philosophy:**
Walter Scott seeks to generate high real returns by combining the best businesses from the best industries in whatever economic area the portfolio is invested. Over the long-term, which the firm defines as an economic cycle of 5-7 years, Walter Scott expects to significantly outperform local market indices and benchmarks. The firm's objective is to target a real rate of return that on average exceeds a minimum of 7%. Historically, Walter Scott has taken very large "bets" relative to EAFE.

**Portfolio Management:**
The firm is an entirely research based investment management firm. The bulk of the time and effort of the firm's personnel is devoted to originating, validating, valuing and implementing research initiatives. This applies equally to the strategic construction of portfolios and the tactical implementation of these portfolios on a day-to-day basis.

The firm makes investments on a team basis. At the strategic level, the approach is based on the identification of major political/economic shifts that are of a secular nature. The firm's approach is that of a research driven fundamentalist.

The research process results in a "library" of companies that meet every requirement for investment, subject to price. A company is actually purchased when the conjunction of P/E and expected 6-year earnings per share growth is consistent with a forecast return of local cost of living plus 7%. Stocks are typically sold when the relationship between P/E, EPS growth and target return breaks down for any reason. The other type of sale occurs when the success of an investment has taken it above normal prudent portfolio limits.

Investments are focused in the most profitable businesses in the world. The firm believes that earnings drive share prices and superior earnings growth occurs most frequently in areas of economic activity that occupy the top quartile of GNP growth. Therefore, portfolios may be void in industries which are in secular economic decline.

**Ownership:**
Walter Scott & Partners Limited is an Edinburgh-based partnership. It was established in 1983.

**Minnesota State Board of Investment**

**Passive Manager Review Committee**

**May 10, 1994**

* note: <u>Selected</u> Pages *

*Richards & Tierney, Inc.*

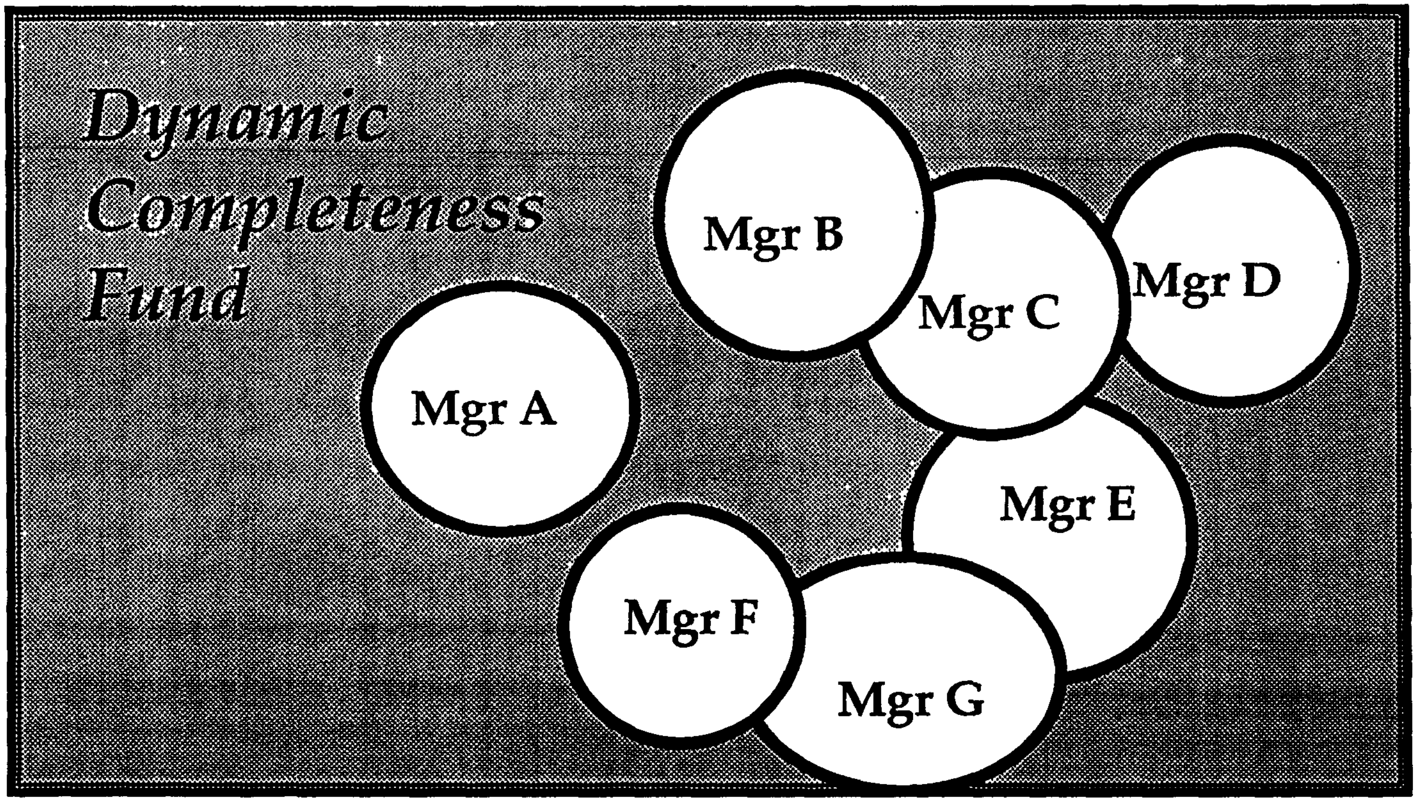
# Outline of Discussion

- Background
  - What is the TIF?
  - Why is MNSBI employing this strategy?
  - Has it worked?
- Review of TIF management process
  - How is TIF benchmark built and maintained?
  - Roles and relationships:
    - SBI
    - R&T
    - Wilshire
- Analysis of turnover and trading of TIF
  - 10/1/90-12/31/93
- Review of current passive manager
  - Performance attribution
- Desirable attributes of implementation manager

# What is the TIF?

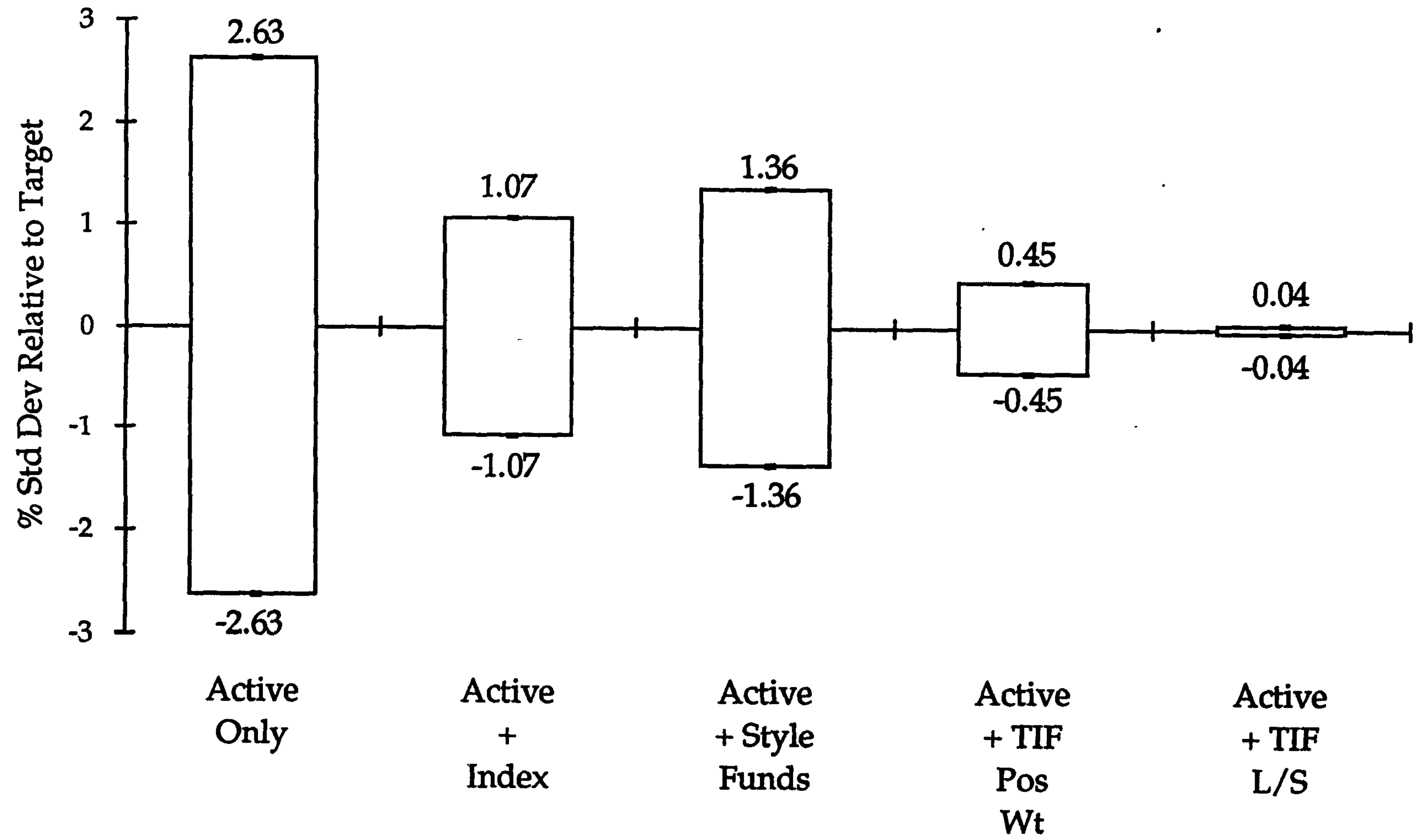
- The TIF is a Dynamic Completeness Fund. What is a DCF?
  - A process by which a plan sponsor can control risk and improve the risk/reward relationship of the overall domestic equity program
  - A portfolio designed to offset unmanaged style bias
  - An unambiguous, measurable, and investable portfolio that is specified in advance
- Can be actively, passively or semi-passively managed
- A DCF is not a simple market capitalization weighted portfolio
  - A passive approach requires sophisticated ability to trade-off transaction costs vs tracking error
- With the DCF, performance of the total equity program will be solely related to the value added returns of the active managers
  - If managers outperform their benchmarks, the total fund will do better than the target
  - If managers underperform their benchmarks, the total program will suffer relative to the target

# Dynamic Completeness Fund




- Box represents the Market Target
- Manager circles represent their area of expertise
- Shaded area represents the Dynamic Completeness Fund

# Misfit Control Alternatives
## Misfit Risk: 3.25 years ended 12/31/93

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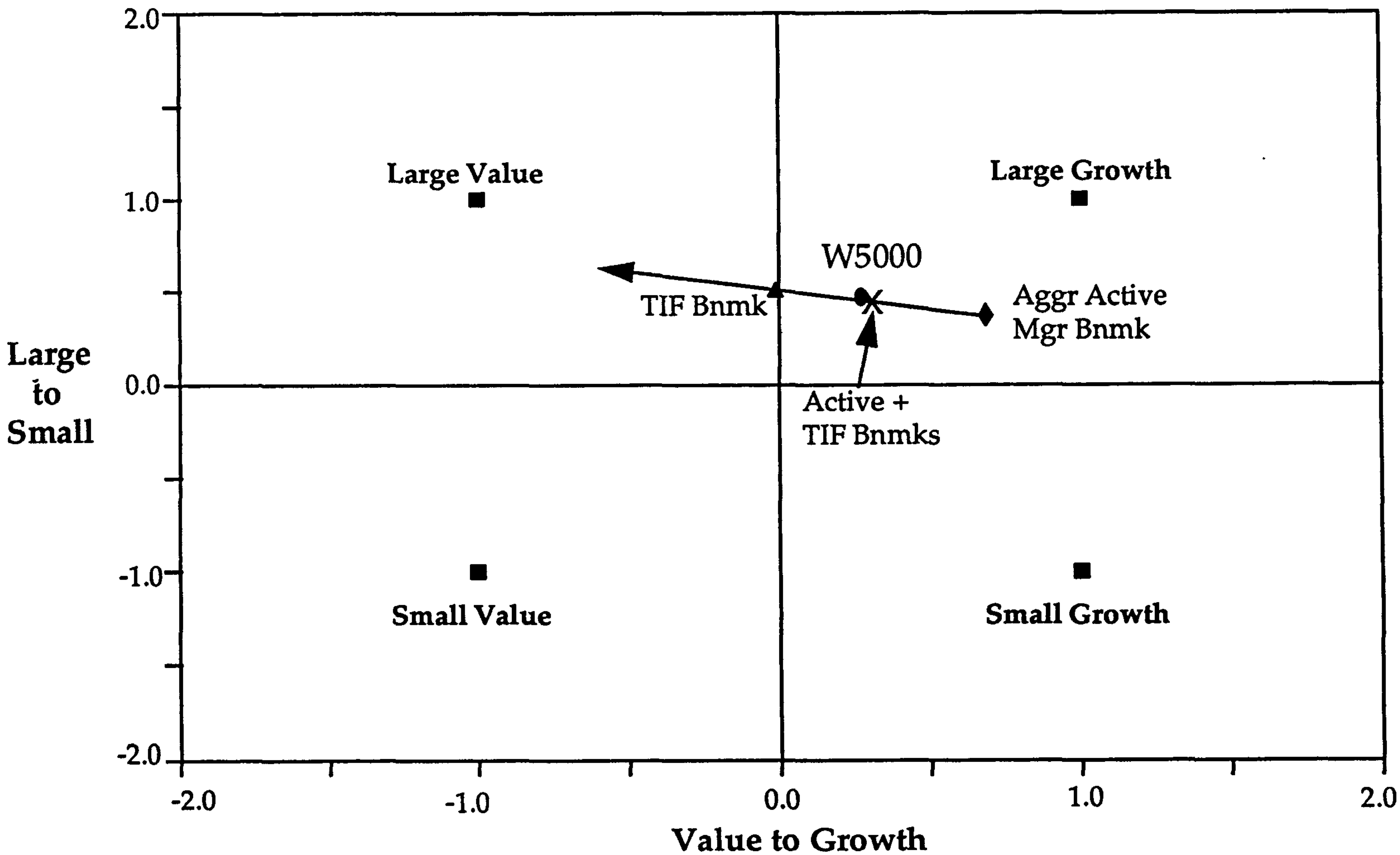
# MN SBI Manager Benchmarks

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# Roles and Relationships

**Plan Sponsor**
**"SBI"**

- Define Target
- Set Allocation Policy
  - %Active managers
  - %TIF
- Active manager assessment

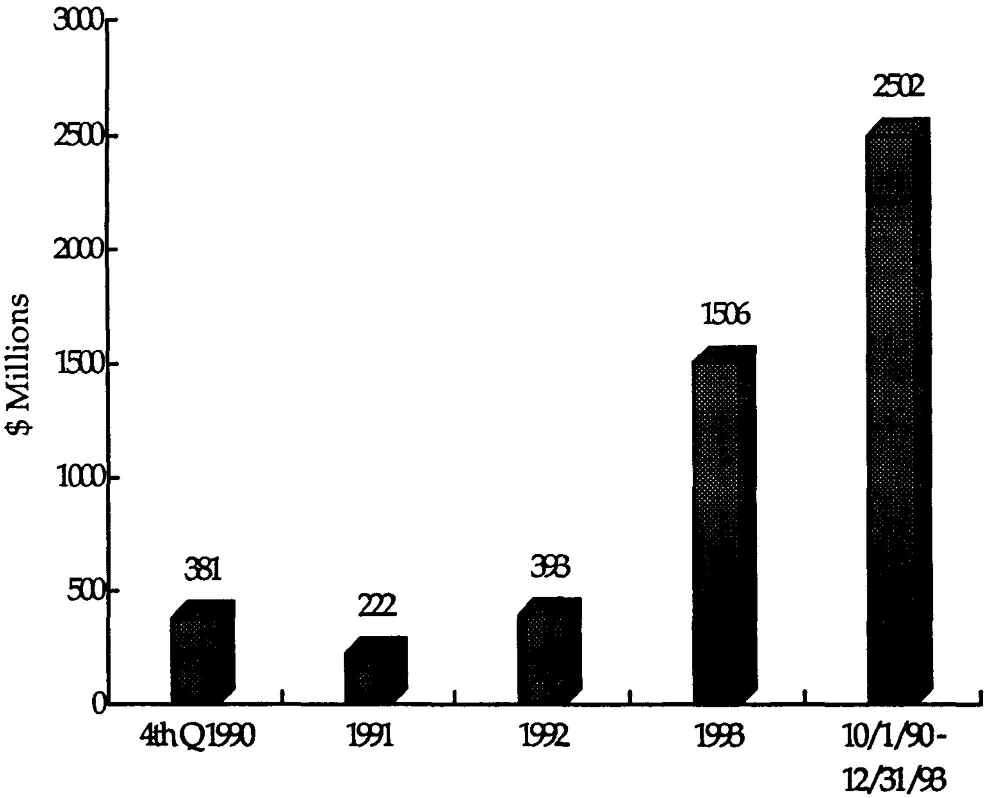
**TIF Benchmark Builder**
**"R&T"**

- Build and rebalance TIF bnmk
- Measure active manager bnmks

**Implementation Manager**
**"Wilshire"**

- Receive and process TIF bnmk
- Manage trade-off
  - tracking error
  - trading costs

# Turnover Attribution
## External Cash Flows (10/1/90 - 12/31/93)




TIF Beginning Value: $2,315 million

TIF Value at 12/31/93: $5,082 million

TIF Average Value: $3,286 million

Total Cash Flows: $ 2,502 million

Annualized Turnover: 23.42%

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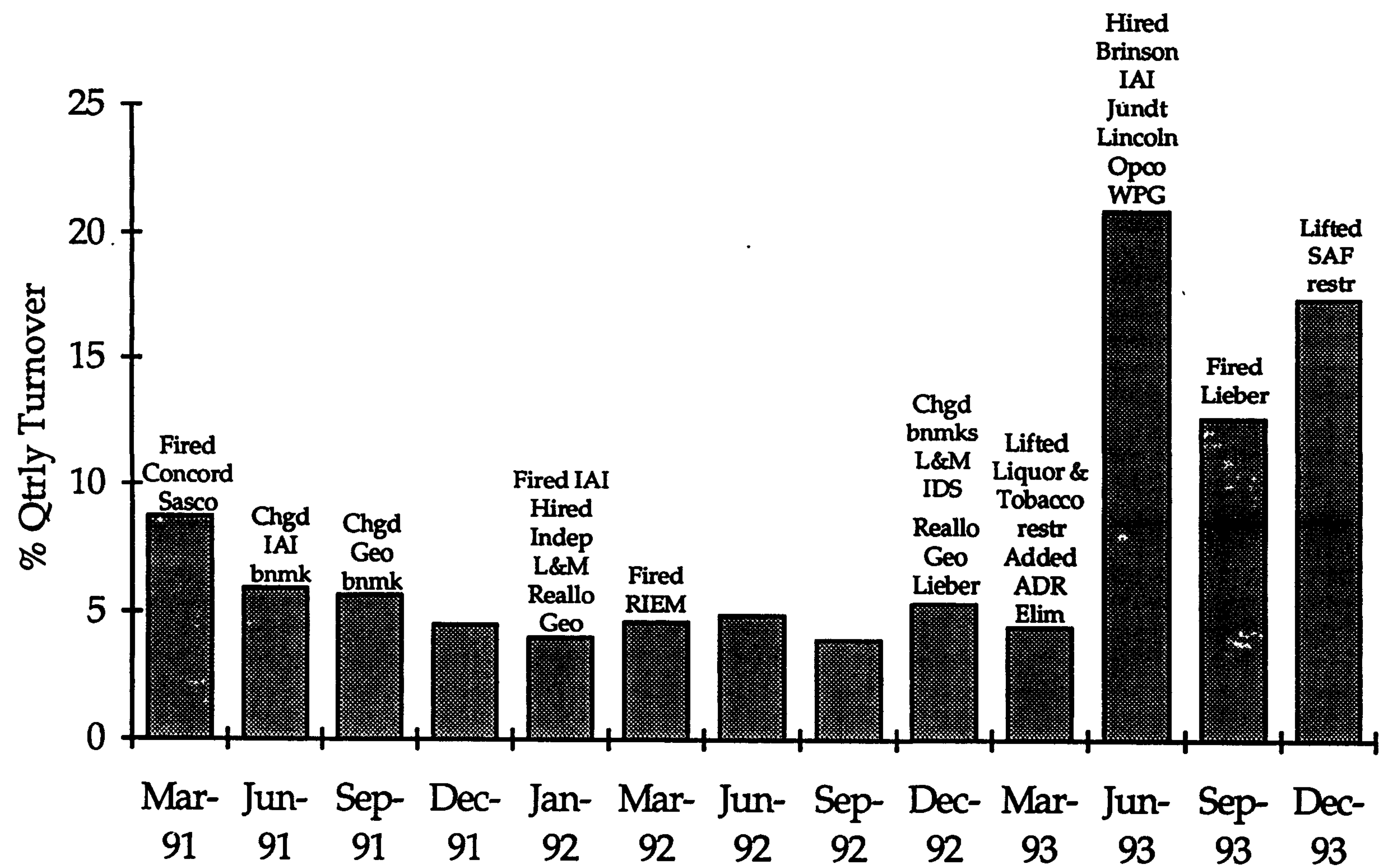
# Turnover Attribution
## MN SBI Equity Program Changes



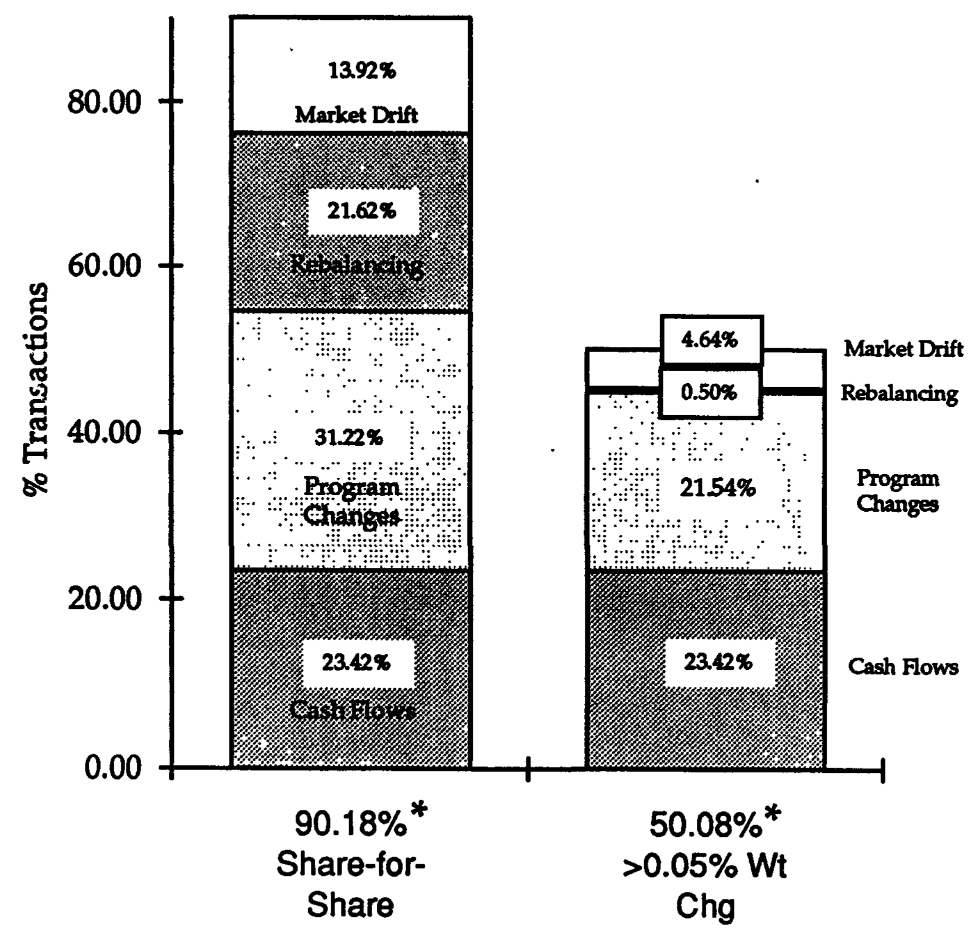

*Richards & Tierney, Inc.*

# TIF Actual Portfolio Performance Attribution

| 10/1/90 - 12/31/93<br>(% Annualized Return) | | Sources | |
|---|---|---|---|
| Actual | 18.37 | Cash Effect | +0.02 |
| Bnmk | 18.85 | Sector | +0.00 |
| VAM | **-0.41** | Selection | -0.14 |
| | | Trading | -0.29 |
| | | | **-0.41** |

# TIF Management Refinements

- ✦ Reduce external cash flows
- ✦ Reduce equity program changes
- ✦ Reduce active manager benchmark turnover
- ✦ Manage the trade-off between tracking error and trading costs
  - Trading results in 'sure' costs
  - Higher tracking allows less trading activity
  - Tighter tracking induces increased trading
- ✦ Use lowest cost trading facilities
  - Internal crossing
  - Crossing networks




*Annualized transactions in TIF as % of portfolio

*Richards & Tierney, Inc.*

# Desired Qualities of TIF Implementation Manager

- Assess to large internal database of securities
- Utilizes a multi-factor risk model and sophisticated optimization techniques
- Ability to analyze the trade-off between tracking error and trading costs
- Quantitatively oriented
- Business strategy accepts custom portfolio assignments
- Access to low cost trading facilities
  - Internal crosses
  - External crossing networks

# STATE BOARD OF INVESTMENT

# Stock Manager Evaluation Reports

## First Quarter, 1994

## DOMESTIC STOCK MANAGERS
### Period Ending 3/31/94

| Current Managers | Quarter Actual % | Quarter Bmk % | 1 Year Actual % | 1 Year Bmk % | 3 Years Actual % | 3 Years Bmk % | 5 Years Actual % | 5 Years Bmk % | Since (1) 1/1/92 Actual % | Since (1) 1/1/92 Bmk % | Since (2) Inception Actual % | Since (2) Inception Bmk % | Market Value (in millions) | Pool % |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Alliance | -4 5 | -2.6 | 1.9 | -0.1 | 12 5 | 7 6 | 16 2 | 10 4 | 7.5 | 3 1 | 16 8 | 11.0 | $684.54 | 7.4% |
| Brinson | -3.4 | -3 3 | | | | | | | | | 1 3 | 2.3 | $251 53 | 2.7% |
| Forstmann-Leff | -3.0 | -3.0 | 5.7 | 2 1 | 9.1 | 9 4 | 9 8 | 10 3 | 4 8 | 7 1 | 12 4 | 11 2 | $351.51 | 3 8% |
| Franklin Portfolio | -2.2 | -3 3 | 5 6 | 3 5 | 13 0 | 12 1 | 12 6 | 11 7 | 11 7 | 9 7 | 12.6 | 11.7 | $361 91 | 3 9% |
| GeoCapital | -2 9 | -4.2 | 13 0 | 15.1 | 14.7 | 15 5 | | | 6 1 | 11 4 | 16.4 | 15 1 | $258.71 | 2.8% |
| IAI | -2.0 | -2.9 | | | | | | | | | 7 3 | 3 5 | $112.03 | 1.2% |
| IDS | -2.6 | -3.0 | 4.4 | 3 5 | 12 0 | 12.1 | 13 7 | 12.2 | 9 1 | 10.2 | 14 2 | 13.5 | $360.42 | 3 9% |
| Independence | -3 9 | -3.7 | 2 0 | 0 8 | | | | | | | 9 1 | 8 1 | $353.45 | 3.8% |
| Jundt Associates | -1.0 | -2.8 | | | | | | | | | 2.7 | 4.4 | $209 43 | 2.3% |
| Lincoln | -3.1 | -2 9 | | | | | | | | | 0.8 | 0 8 | $243 96 | 2 6% |
| Lynch & Mayer | -2 2 | -2.3 | -0.6 | 8.1 | | | | | | | 6 2 | 8 9 | $309 93 | 3.4% |
| Oppenheimer | -2 8 | -2.7 | | | | | | | | | 2 3 | 1.5 | $253.67 | 2.7% |
| Waddell & Reed | 1 7 | -1.4 | 13.6 | 11 8 | 13.8 | 13.2 | 13.3 | 11 9 | 13.5 | 12.5 | 12 1 | 11 5 | $390.17 | 4 2% |
| Weiss Peck & Greer | -4 3 | -3.4 | | | | | | | | | 2.1 | 6 3 | $206.02 | 2.2% |
| Emerging Managers (3) | | | | | | | | | | | | | | |
| Wilshire Associates (4) | -4.2 | -4 2 | 1.2 | 1.7 | 9 8 | 10 1 | 11.3 | 11 8 | 6.6 | 7.1 | 13 0 | 13 2 | $4,877.44 | 52.9% |
| | | | | | | | | | | | | | $9,224.74 | 100 0% |
| | | | | | | | | | | | Since 1/1/84 | | | |
| Current Aggregate | -3 5 | -3.6 | 2 8 | 3 0 | 10 8 | 10.4 | 12.4 | 11 8 | 7.3 | 7.4 | 13 6 | 13.1 | | |
| **Historical Aggregate (5)** | **-3.5** | **-3.6** | **2.6** | **2.9** | **10.3** | **10.4** | **11.7** | **11.6** | **7.0** | **7.5** | **12.9** | **13.1** | | |
| Wilshire Adjusted (6) | | -3.8 | | 2 5 | | 10.3 | | 11 8 | | 7.1 | | 13 1 | | |
| Wilshire 5000 | | -3.8 | | 2 8 | | 10.4 | | 12 1 | | 7.2 | | 13 4 | | |

(1) Since tilted index fund was fully implemented
(2) Since retention by the SBI. Time period varies for each manager
(3) Aggregate of emerging manager group.
(4) Passive manager Tilted index fund began 10/90. Fully implemented 1/92.
(5) Includes performance of terminated managers.
(6) Buy hold index adjusted for liquor and tobacco restrictions through 3/31/93 and AHP restriction through 10/31/93.

## ALLIANCE CAPITAL MANAGEMENT
## Period Ending 3/31/94

**Portfolio Manager: Jack Koltes** **Assets Under Management: $684,543,594**

### Investment Philosophy

Alliance searches for companies likely to experience high rates of earnings growth, on either a cyclical or secular basis. Alliance invests in a wide range of growth opportunities from small, emerging growth to large, cyclically sensitive companies. There is no clear distinction on the part of the firm as to an emphasis on one particular type of growth company over another. However, the firm's decision-making process appears to be much more oriented toward macroeconomic considerations than is the case with most other growth managers. Accordingly, cyclical earnings prospects, rather than secular, appear to play a larger role in terms of stock selection. Alliance is not an active market timer, rarely raising cash above minimal levels.

### Qualitative Evaluation (reported by exception)

**Exceptional strengths are:**

—Highly successful and experienced professionals.

—Organizational continuity and strong leadership.

—Well-acquainted with needs of large clients.

—Investment style consistently and successfully applied over a variety of market environments.

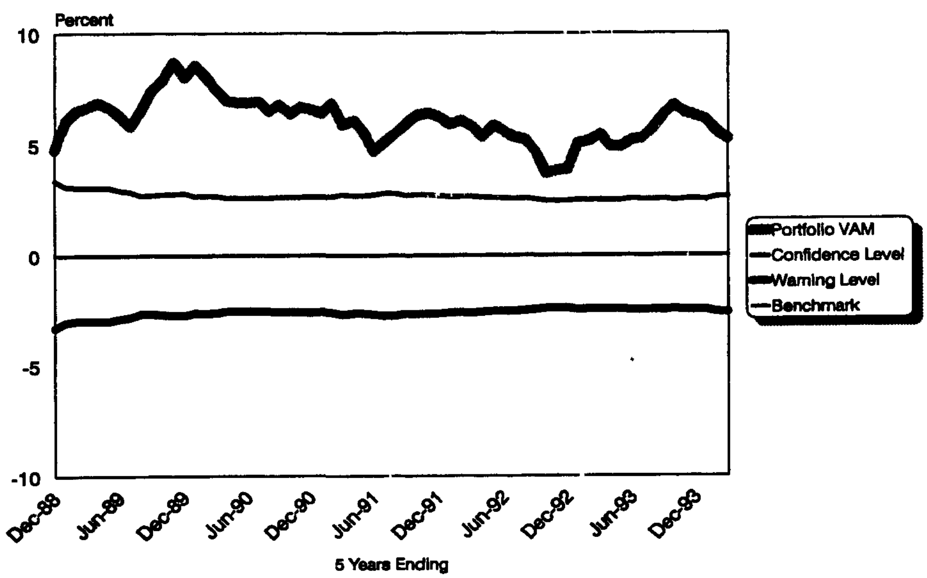
### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -4.5% | -2.6% |
| Last 1 year | 1.9 | -0.1 |
| Last 2 years | 9.6 | 5.5 |
| Last 3 years | 12.5 | 7.6 |
| Last 4 years | 13.9 | 9.3 |
| Last 5 years | 16.2 | 10.4 |
| Since Inception (1/84) | 16.8 | 11.0 |

### Recommendations

No action recommended.

Alliance Capital Management
Rolling Five Year Time Periods




Note: Graph uses 80/20 confidence interval.

## BRINSON PARTNERS
## Period Ending 3/31/94

**Portfolio Manager: Jeff Diermeier** **Assets Under Management: $251,532,841**

### Investment Philosophy

Brinson Partners uses a relative value approach to equity investing. They believe that the market price will ultimately reflect the present value of the cash flows that the security will generate for the investor. They also believe both a macroeconomic theme approach and a bottom-up stock selection process can provide insight into finding opportunistic investments. Brinson uses their own discounted free cash flow model as their primary analytical tool for estimating the intrinsic value of a company.

### Qualitative Evaluation (reported by exception)

**Exceptional strengths are:**

—Familiar with the needs of large institutional clients.

—Highly successful and experienced professionals.

—Investment style consistently and successfully applied over a variety of market environments.

### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -3.4% | -3.3% |
| Last 1 year | N/A | N/A |
| Last 2 years | N/A | N/A |
| Last 3 years | N/A | N/A |
| Last 4 years | N/A | N/A |
| Last 5 years | N/A | N/A |
| Since Inception (7/93) | 1.3 | 2.3 |

### Recommendations

No action recommended.

**VAM graph will be created for period ending 6/30/95.**

## FORSTMANN LEFF ASSOCIATES
## Period Ending 3/31/94

**Portfolio Manager: Joel Leff** **Assets Under Management: $351,510,790**

### Investment Philosophy

Forstmann Leff is a classic example of a "rotational" manager. The firm focuses almost exclusively on asset mix and sector weighting decisions. Based upon its macroeconomic outlook, the firm will move aggressively into and out of equity sectors over the course of a market cycle. The firm tends to purchase liquid, large capitalization stocks. In the past, Forstmann Leff has made sizable market timing moves at any point during a market cycle.

### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -3.0% | -3.0% |
| Last 1 year | 5.7 | 2.1 |
| Last 2 years | 6.5 | 7.3 |
| Last 3 years | 9.1 | 9.4 |
| Last 4 years | 10.6 | 9.9 |
| Last 5 years | 9.8 | 10.3 |
| Since Inception (1/84) | 12.4 | 11.2 |

### Qualitative Evaluation
### (reported by exception)

**Current Concerns are:**

—Relatively high turnover among firm's professionals. This issue, while not serious, remains outstanding.

**Exceptional strengths are:**

—Highly successful and experienced leadership.

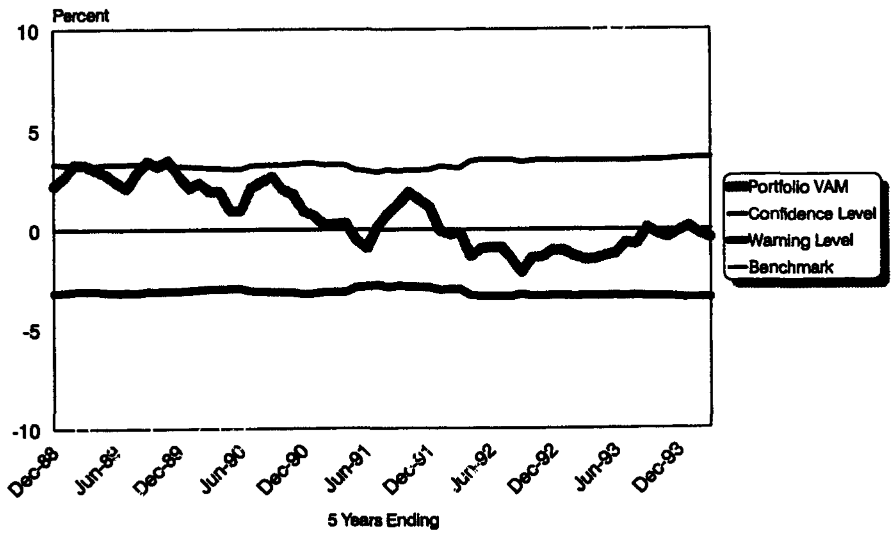
—Investment style consistently and successfully applied over a variety of market environments.

—Well acquainted with needs of large clients.

### Recommendations

No action recommended.

FORSTMANN-LEFF ASSOCIATES
Rolling Five Year Time Periods




Note: Graph uses 80/20 confidence interval.

## FRANKLIN PORTFOLIO ASSOCIATES
## Period Ending 3/31/94

**Portfolio Manager: John Nagorniak** — **Assets Under Management: $361,914,301**

### Investment Philosophy

Franklin's investment decisions are quantitatively driven and controlled. The firm's stock selection model uses 30 valuation measures covering the following factors: fundamental momentum, relative value, future cash flow, and economic cycle analysis. The firm believes that a multi-dimensional approach to stock selection provides greater consistency than reliance on a limited number of valuation criteria. Franklin's portfolio management process focuses on buying and selling the right stock rather than attempting to time the market or to pick the right sector or industry groups. The firm remains fully invested at all times.

### Qualitative Evaluation (reported by exception)

**Exceptional strengths are:**

—Familiar with the needs of large institutional clients.

—Firm's investment approach has been consistently applied over a number of market cycles.

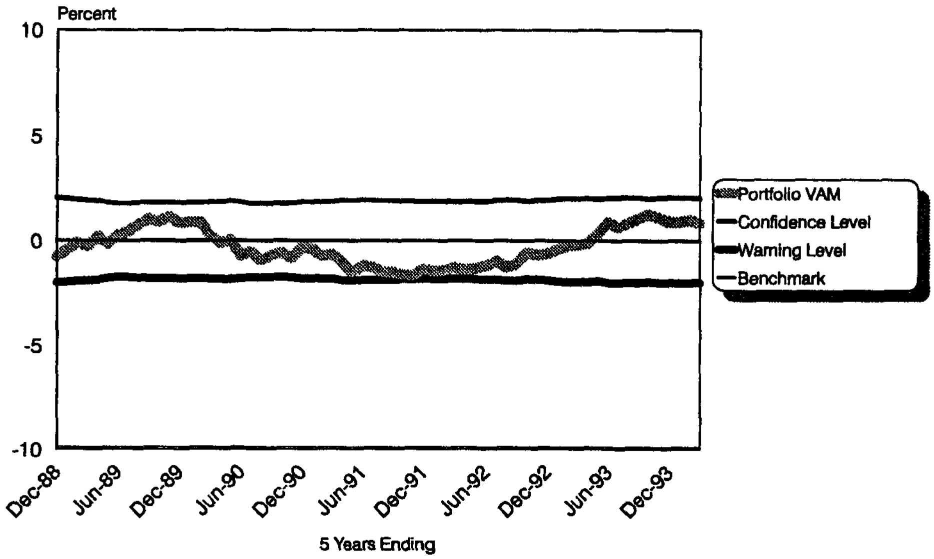
### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -2.2% | -3.3% |
| Last 1 year | 5.6 | 3.5 |
| Last 2 years | 14.2 | 11.1 |
| Last 3 years | 13.0 | 12.1 |
| Last 4 years | 12.1 | 12.1 |
| Last 5 years | 12.6 | 11.7 |
| Since Inception (4/89) | 12.6 | 11.7 |

### Recommendations

No action recommended.

FRANKLIN PORTFOLIO
Rolling Five Year Time Periods




Note: Shaded area includes performance prior to managing SBI account. Graph uses 80/20 confidence interval

# GEOCAPITAL CORP.
## Period Ending 3/31/94

**Portfolio Manager: Barry Fingerhut** **Assets Under Management: $258,708,578**

### Investment Philosophy

GeoCapital invests primarily in small capitalization equities with the intent to hold them as they grow into medium and large capitalization companies. The firm uses a theme approach and an individual stock selection analysis to invest in the growth/technology and intrinsic value areas of the market. In the growth/technology area, GeoCapital looks for companies that will have above average growth due to a good product development program and limited competition. In the intrinsic value area, the key factors in this analysis are corporate assets, free cash flow, and a catalyst that will cause a positive change in the company. The firm generally stays fully invested, with any cash positions due to the lack of attractive investment opportunities.

### Qualitative Evaluation (reported by exception)

**Exceptional strengths are:**

—Investment style consistently and successfully applied over a variety of market environments.

—Attractive, unique investment approach.

—Highly successful and experienced professionals.

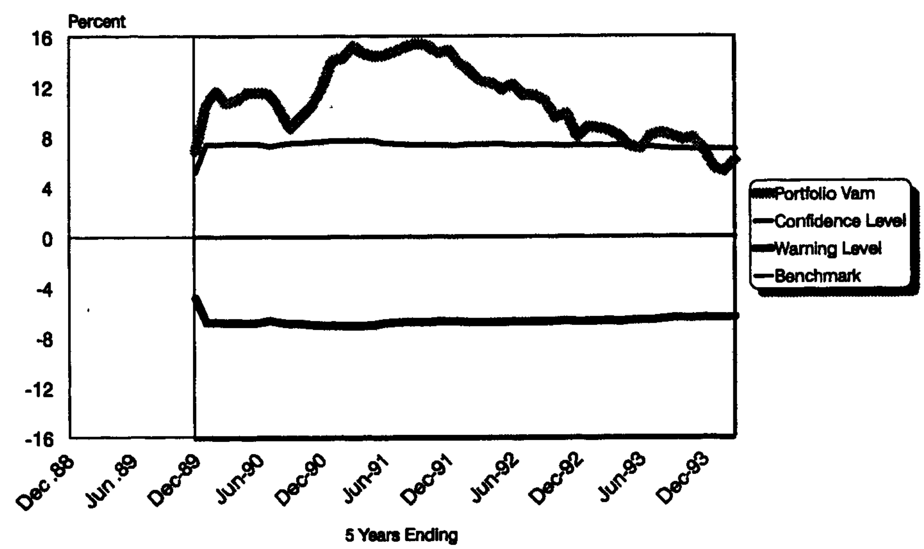
### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -2.9% | -4.2% |
| Last 1 year | 13.0 | 15.1 |
| Last 2 years | 8.5 | 13.5 |
| Last 3 years | 14.7 | 15.5 |
| Last 4 years | N/A | N/A |
| Last 5 years | N/A | N/A |
| Since Inception (4/90) | 16.4 | 15.1 |

### Recommendations

No action recommended.

GEOCAPITAL
Rolling Five Year Time Periods




Note: Shaded area includes performance prior to managing SBI account.
Scale differs from other manager VAM graphs. Graph uses 80/20 confidence interval.

## INVESTMENT ADVISERS
**Period Ending 3/31/94**

**Portfolio Manager: Julian (Bing) Carlin** **Assets Under Management: $112,027,425**

### Investment Philosophy

IAI's investment philosophy is to own the highest quality companies which demonstrate sustainable growth and the objective of this discipline is capital appreciation. IAI tries to achieve this objective by investing at least 80% of the portfolio in companies which have their headquarters in Minnesota, Wisconsin, Illinois, Iowa, Nebraska, Montana, North Dakota and South Dakota. Twenty percent of the portfolio can be used to purchase large capitalization stocks that display the same quality and growth characteristics but have headquarters outside this region.

### Qualitative Evaluation (reported by exception)

**Exceptional strengths are:**

—Attractive, unique investment approach.

—Investment style successfully applied over a number of market cycles.

### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -2.0% | -2.9% |
| Last 1 year | N/A | N/A |
| Last 2 years | N/A | N/A |
| Last 3 years | N/A | N/A |
| Last 4 years | N/A | N/A |
| Last 5 years | N/A | N/A |
| Since Inception (7/93) | 7.3 | 3.5 |

### Recommendations

No action recommended.

**VAM graph will be created for period ending 6/30/95.**

## IDS ADVISORY
**Period Ending 3/31/94**

**Portfolio Manager: Pete Anderson** | **Assets Under Management: $360,421,745**

### Investment Philosophy

IDS employs a "rotational" style of management, shifting among industry sectors based upon its outlook for the economy and the financial markets. The firm emphasizes primarily sector weighting decisions. Moderate market timing is also used. Over a market cycle, IDS will invest in a wide range of industries. It tends to buy liquid, large capitalization stocks. While IDS will make occasional significant asset mix shifts over a market cycle, the firm is a less aggressive market timer than most rotational managers.

### Qualitative Evaluation
### (reported by exception)

**Exceptional strengths are:**

—Investment style consistently and successfully applied over a variety of market environments.

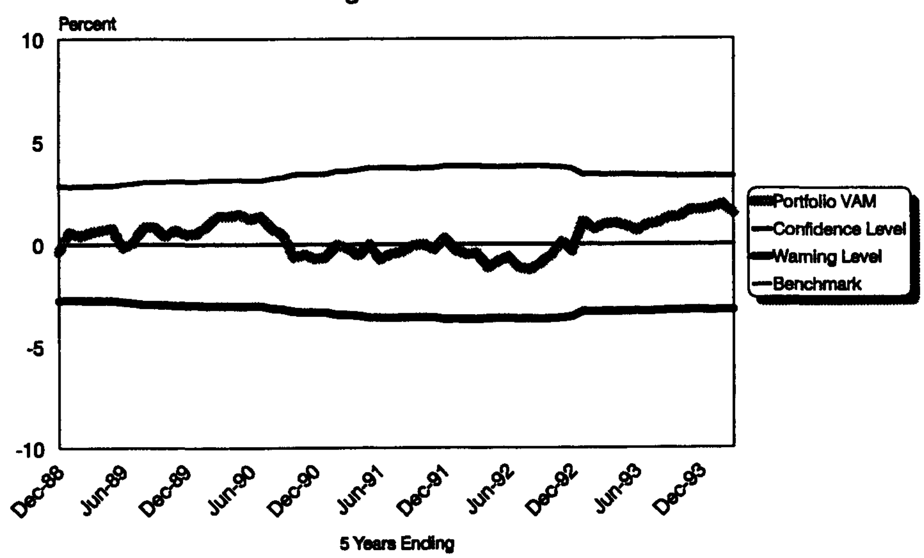
### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -2.6% | -3.0% |
| Last 1 year | 4.4 | 3.5 |
| Last 2 years | 10.8 | 10.8 |
| Last 3 years | 12.0 | 12.1 |
| Last 4 years | 11.2 | 11.6 |
| Last 5 years | 13.7 | 12.2 |
| Since Inception (1/84) | 14.2 | 13.5 |

### Recommendations

No action recommended.

IDS ADVISORY
Rolling Five Year Time Periods




Note: Graph uses 80/20 confidence interval.

## INDEPENDENCE INVESTMENT ASSOCIATES
## Period Ending 3/31/94

**Portfolio Manager: Bill Fletcher** **Assets Under Management: $353,451,029**

### Investment Philosophy

Independence believes that individual stocks which outperform the market always have two characteristics: they are intrinsically cheap and their business is in the process of improving. Independence ranks their universe using a multifactor model. Based on input primarily generated by their internal analysts, the model ranks each stock based on 10 discreet criteria. Independence constricts their portfolio to the top 60% of their ranked universe. The portfolio is optimized relative to the benchmark selected by the client to minimize the market and industry risks. Independence maintains a fully invested portfolio and rarely holds more than a 1% cash position.

### Qualitative Evaluation (reported by exception)

**Exceptional strengths are:**

—Investment style consistently and successfully applied over a variety of market environments.

—Attractive, unique investment approach.

—Highly successful and experienced professionals.

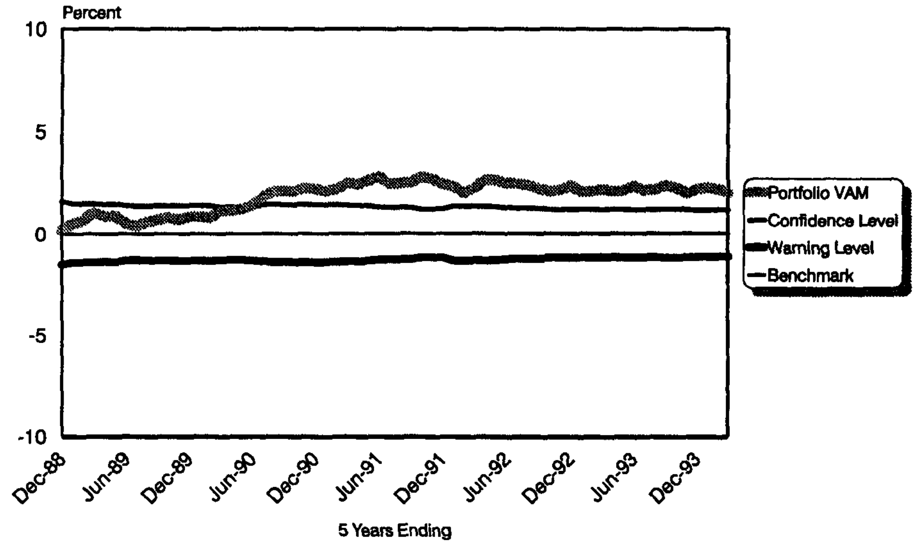
### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -3.9% | -3.7% |
| Last 1 year | 2.0 | 0.8 |
| Last 2 years | 10.2 | 9.0 |
| Last 3 years | N/A | N/A |
| Last 4 years | N/A | N/A |
| Last 5 years | N/A | N/A |
| Since Inception (2/92) | 9.1 | 8.1 |

### Recommendations

No action recommended

INDEPENDENCE INVESTMENT ASSOCIATES
Rolling Five Year Time Periods




Note: Shaded area includes performance prior to managing SBI account. Graph uses 80/20 confidence interval

## JUNDT ASSOCIATES
## Period Ending 3/31/94

**Portfolio Manager: James Jundt** | **Assets Under Management: $209,428,751**

### Investment Philosophy

Jundt Associates' investment philosophy is growth oriented with a focus on companies generating significant revenue increases. They concentrate on larger-capitalization companies, with at least half the equity securities consisting of companies with annual revenues over $750 million. Within these parameters, the firm's mission is to establish equity positions in 30 to 50 of the fastest growing corporations in America. Particular emphasis is placed on companies the firm believes will achieve annual revenue growth of 15% or greater. Jundt utilizes a bottom-up stock selection process combined with a top-down theme overlay. The firm attempts to identify five to seven investment themes and typically invests three to five stocks in each theme.

### Qualitative Evaluation (reported by exception)

**Exceptional strengths are:**

—Attractive, unique investment approach.

—Investment style has been consistently applied over a number of market cycles.

**Current concerns are:**

—One of the firm's four partners resigned last quarter. While a replacement has been hired, this transition should be monitored going forward.

### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -1.0% | -2.8% |
| Last 1 year | N/A | N/A |
| Last 2 years | N/A | N/A |
| Last 3 years | N/A | N/A |
| Last 4 years | N/A | N/A |
| Last 5 years | N/A | N/A |
| Since Inception (7/93) | 2.7 | 4.4 |

### Recommendations

No action recommended.

**VAM graph will be created for period ending 6/30/95.**

## LINCOLN CAPITAL MANAGEMENT
**Period Ending 3/31/94**

**Portfolio Manager: Parker Hall** | **Assets Under Management: $243,960,948**

### Investment Philosophy

Lincoln Capital concentrates on established medium to large capitalization companies that have demonstrated historically strong growth and will continue to grow. The firm uses traditional fundamental company analysis and relative price/earnings valuation disciplines in its stock selection process. In addition, companies held by Lincoln generally exhibit premium price/book ratios, high return on equity, strong balance sheets and moderate earnings variability.

### Qualitative Evaluation (reported by exception)

**Exceptional strengths are:**

—Organizational continuity and strong leadership.

—Familiar with the needs of large clients.

—Investment style has been consistently applied over a number of market cycles.

### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -3.1% | -2.9% |
| Last 1 year | N/A | N/A |
| Last 2 years | N/A | N/A |
| Last 3 years | N/A | N/A |
| Last 4 years | N/A | N/A |
| Last 5 years | N/A | N/A |
| Since Inception (7/93) | 0.8 | 0.8 |

### Recommendations

No action recommended.

**VAM graph will be created for period ending 6/30/95.**

## LYNCH & MAYER
## Period Ending 3/31/94

**Portfolio Manager: Eldon Mayer** — **Assets Under Management: $309,929,870**

### Investment Philosophy

Lynch & Mayer invest primarily in high-quality, large capitalization growth stocks. They believe that outstanding investments are a function of corporate earnings growth that is considerably above historical trends or consensus expectations. Lynch & Mayer are bottom up stock pickers and rely on very little economic analysis in their selection process. The firm screens out stocks below a certain market capitalization and liquidity level and then eliminates additional stocks based on various fundamental criteria. After the screening process they look for at least one of the following four factors: 1) acceleration of growth; 2) improving industry environment; 3) corporate restructuring; or 4) turnaround. The firm generally stays fully invested, with any cash due to lack of attractive investment opportunities.

### Qualitative Evaluation (reported by exception)

**Exceptional strengths are:**

—Organizational continuity and strong leadership.

—Highly successful and experienced professionals.

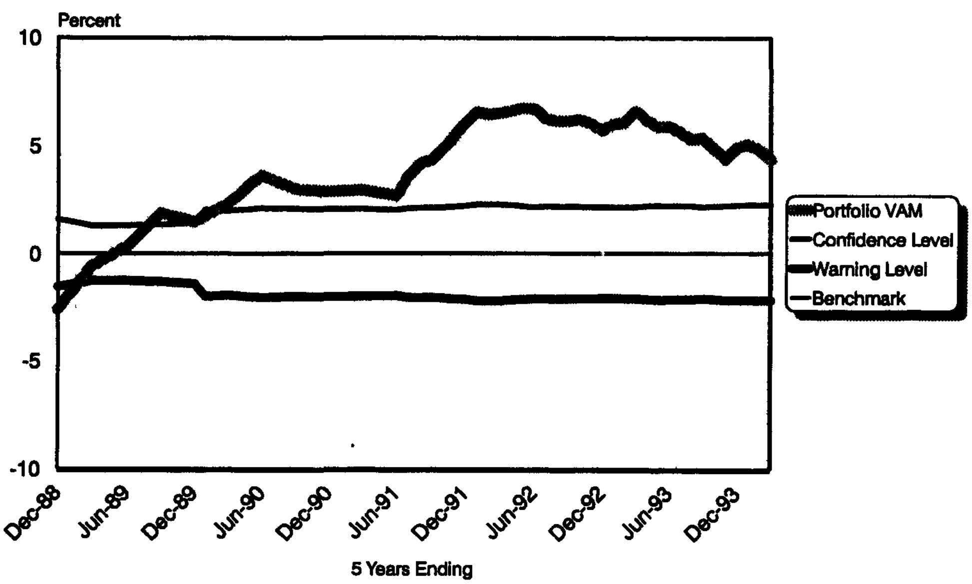
### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -2.2% | -2.3% |
| Last 1 year | -0.6 | 8.1 |
| Last 2 years | 6.6 | 10.8 |
| Last 3 years | N/A | N/A |
| Last 4 years | N/A | N/A |
| Last 5 years | N/A | N/A |
| Since Inception (2/92) | 6.2 | 8.9 |

### Recommendations

No action recommended.

LYNCH & MAYER
Rolling Five Year Time Periods




Note: Shaded area includes performance prior to managing SBI account. Graph uses 80/20 confidence interval.

## OPPENHEIMER CAPITAL
## Period Ending 3/31/94

**Portfolio Manager: John Lindenthal** | **Assets Under Management: $253,672,941**

### Investment Philosophy

Oppenheimer's objectives are to: 1) preserve capital in falling markets; 2) manage risk in order to achieve less volatility than the market; and 3) produce returns greater than the market indices, the inflation rate and a universe of comparable portfolios with similar objectives. The firm achieves its objectives by purchasing securities considered to be undervalued on the basis of known data and strict financial standards and by making timely changes in the asset mix. Based on its outlook on the market and the economy, Oppenheimer will make moderate shifts between cash and equities. Oppenheimer focuses on five key variables when evaluating companies: management, financial strength, profitability, industrial position and valuation.

### Qualitative Evaluation (reported by exception)

**Exceptional strengths are:**

—Highly successful and experienced professionals.

—Familiar with the needs of large institutional clients.

—Investment style has been consistently applied over a number of market cycles.

### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -2.8% | -2.7% |
| Last 1 year | N/A | N/A |
| Last 2 years | N/A | N/A |
| Last 3 years | N/A | N/A |
| Last 4 years | N/A | N/A |
| Last 5 years | N/A | N/A |
| Since Inception (7/93) | 2.3 | 1.5 |

### Recommendations

No action recommended.

**VAM graph will be created for period ending 6/30/95.**

## WADDELL & REED ASSET MANAGEMENT
## Period Ending 3/31/94

**Portfolio Manager: Henry Herrmann** — **Assets Under Management: $390,171,509**

### Investment Philosophy

Waddell & Reed focuses its attention primarily on smaller capitalization growth stocks. However, the firm has demonstrated a willingness to make significant bets against this investment approach for extended periods of time and has been very eclectic in its choice of stocks in recent years. The firm is an active market timer and will raise cash to extreme levels at various points in the market cycle.

### Qualitative Evaluation (reported by exception)

**Exceptional strengths are:**

—Highly successful and experienced professionals.

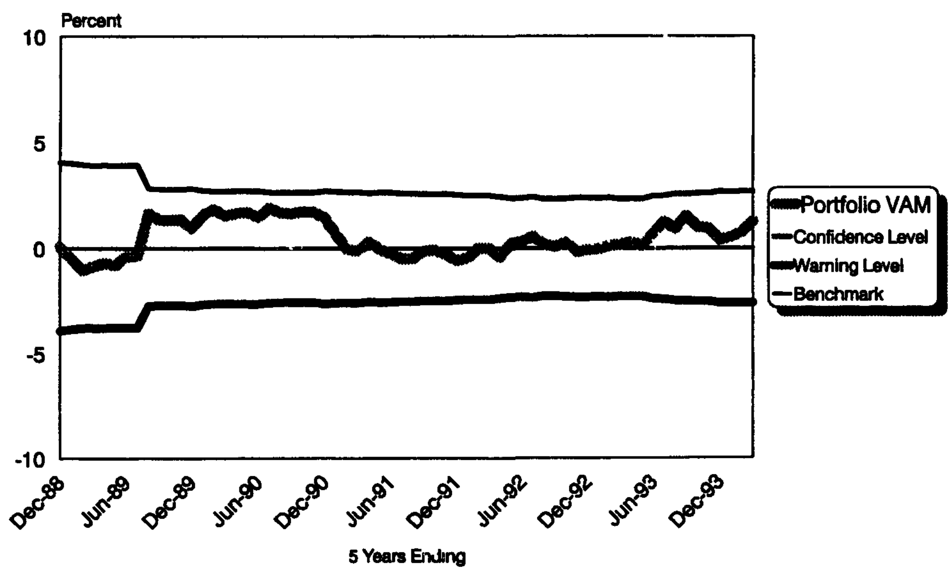
### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | 1.7% | -1.4% |
| Last 1 year | 13.6 | 11.8 |
| Last 2 years | 13.3 | 12.1 |
| Last 3 years | 13.8 | 13.2 |
| Last 4 years | 11.7 | 12.1 |
| Last 5 years | 13.3 | 11.9 |
| Since Inception (1/84) | 12.1 | 11.5 |

### Recommendations

No action recommended.

WADDELL & REED
Rolling Five Year Time Periods




Note: Graph uses 80/20 confidence interval.

## WEISS, PECK & GREER
## Period Ending 3/31/94

**Portfolio Manager: Melville Straus** — **Assets Under Management: $206,023,972**

### Investment Philosophy

Weiss, Peck & Greer's dynamic growth process concentrates on small to medium size growth companies that have demonstrated consistent superior earnings growth rates. The process emphasizes companies in new or dynamic, rapidly growing industries where there is a potential for a major acceleration in earnings growth. The firm also believes that superior stock selection can be achieved through in-depth fundamental company research.

### Qualitative Evaluation (reported by exception)

**Exceptional strengths are:**

—Highly successful and experienced professionals.

—Investment style has been consistently applied over a number of market cycles.

### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -4.3% | -3.4% |
| Last 1 year | N/A | N/A |
| Last 2 years | N/A | N/A |
| Last 3 years | N/A | N/A |
| Last 4 years | N/A | N/A |
| Last 5 years | N/A | N/A |
| Since Inception (7/93) | 2.1 | 6.3 |

### Recommendations

No action recommended

**VAM graph will be created for period ending 6/30/95.**

# STATE BOARD OF INVESTMENT

## Bond Manager Evaluation Reports

**First Quarter, 1994**

## DOMESTIC BOND MANAGERS
### Period Ending 3/31/94

| Current Managers | Quarter Actual % | Quarter Bmk % | 1 Year Actual % | 1 Year Bmk % | 3 years Actual % | 3 years Bmk % | 5 Years Actual % | 5 Years Bmk % | Since (1) Inception Actual % | Since (1) Inception Bmk % | Market Value (in millions) | Pool % |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| BEA | -3.0 | -2.8 | | | | | | | 0.2 | -0.3 | $279.54 | 4.7% |
| IAI | -3.5 | -2.8 | 3.2 | 2.5 | 10.4 | 9.1 | 11.2 | 10.5 | 12.5 | 12.1 | 462.02 | 7.7% |
| Miller | -2.9 | -2.8 | 4.2 | 2.5 | 11.0 | 9.1 | 10.7 | 10.5 | 12.3 | 12.1 | 466.06 | 7.8% |
| Standish | -3.3 | -2.8 | | | | | | | -0.3 | -0.2 | 458.48 | 7.6% |
| Western | -3.3 | -2.8 | 4.9 | 2.5 | 10.9 | 9.2 | 11.7 | 10.5 | 13.3 | 12.0 | 855.68 | 14.2% |
| IDS (2) | -3.4 | -3.1 | | | | | | | -0.2 | -0.2 | 238.22 | 4.0% |
| TCW (3) | -1.7 | -2.1 | | | | | | | 1.2 | -0.3 | 241.25 | 4.0% |
| Goldman (4) | -2.6 | -2.8 | | | | | | | 0.6 | -0.3 | 1,007.14 | 16.8% |
| Fidelity (4) | -2.5 | -2.8 | 3.6 | 2.5 | 9.6 | 9.1 | 10.9 | 10.5 | 10.1 | 9.8 | 1,002.33 | 16.7% |
| Lincoln (4) | -2.6 | -2.8 | 2.7 | 2.5 | 9.2 | 9.1 | 10.4 | 10.5 | 9.8 | 9.8 | 996.84 | 16.6% |
| | | | | | | | | | | | $6,007.56 | 100.0% |
| | | | | | | | | | **Since 7/1/84** | | | |
| Current Aggregate | -2.8 | -2.8 | 3.6 | 2.6 | 10.0 | 9.1 | 10.9 | 10.5 | 12.6 | 12.0 | | |
| **Historical Aggregate (5)** | **-2.8** | **-2.8** | **3.6** | **2.6** | **9.9** | **9.1** | **10.8** | **10.5** | **11.9** | **11.9** | | |
| Salomon BIG | | -2.8 | | 2.5 | | 9.1 | | 10.5 | | 12.1 | | |

(1) Since retention by the SBI. Time period varies for each manager.
(2) Govt./Corp. only.
(3) Mortgages only.
(4) Semi- passive manager.
(5) Includes performance of terminated managers.

## BEA ASSOCIATES
## Period Ending 3/31/94

**Portfolio Manager: Bob Moore** **Assets Under Management: $279,538,516**

### Investment Philosophy

BEA's investment approach focuses on individual bond selection and on sector selection rather than short term interest rate forecasting. BEA keeps the duration close to the benchmark but may be slightly longer or shorter depending on their long-term economic outlook. BEA's approach is distinguished by 1) a quantitative approach which avoids market timing; 2) contrarian weightings of bond sectors and 3) rigorous call and credit analysis rather than yield driven management.

### Qualitative Evaluation (reported by exception)

**Exceptional strengths are:**

—Highly successful and experienced professionals.

—Extensive option analysis capabilities.

### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -3.0% | -2.8% |
| Last 1 year | N/A | N/A |
| Last 2 years | N/A | N/A |
| Last 3 years | N/A | N/A |
| Last 4 years | N/A | N/A |
| Last 5 years | N/A | N/A |
| Since Inception (7/93) | 0.2 | -0.3 |

### Recommendations

No action recommended.

**VAM graph will be drawn for period ending 9/30/95.**

## IDS ADVISORY GROUP
## Period Ending 3/31/94

**Portfolio Manager: Ed Labenski** **Assets Under Management: $238,219,023**

### Investment Philosophy

IDS manages a corporate and treasury portfolio for the SBI. The firm uses duration management combined with in-depth fundamental analysis of the corporate sector to add value to the portfolio. Active duration management begins with an economic overview and interest rate outlook. These factors help IDS determine the direction of both short and long-term interest rates which leads to the portfolio duration decisions. After IDS determines duration, they use their extensive corporate research capabilities to determine corporate sector allocation and to select individual issues.

### Qualitative Evaluation
### (reported by exception)

**Exceptional strengths are:**

—Highly successful and experienced professionals.

—Extensive corporate research capabilities.

### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -3.4% | -3.1% |
| Last 1 year | N/A | N/A |
| Last 2 years | N/A | N/A |
| Last 3 years | N/A | N/A |
| Last 4 years | N/A | N/A |
| Last 5 years | N/A | N/A |
| Since Inception (7/93) | -0.2 | -0.2 |

### Recommendations

No action recommended.

**VAM graph will be drawn for period ending 9/30/95.**

# INVESTMENT ADVISERS
**Period Ending 3/31/94**

**Portfolio Manager: Larry Hill** | **Assets Under Management: $462,020,013**

## Investment Philosophy

Investment Advisers is a traditional top down bond manager. The firm's approach is oriented toward correct identification of the economy's position in the credit cycle. This analysis leads the firm to its interest rate forecast and maturity decisions, from which the firm derives most of its value-added. Investment Advisers is an active asset allocator, willing to make rapid, significant moves between cash and long maturity investments over the course of an interest rate cycle. Quality and sector choices are made through yield spread analyses consistent with the interest rate forecasts. Individual security selection receives very limited emphasis and focuses largely on specific bond characteristics such as call provisions.

## Qualitative Evaluation (reported by exception)

**The current evaluation notes the following:**

— The manager's duration decisions have added value recently.

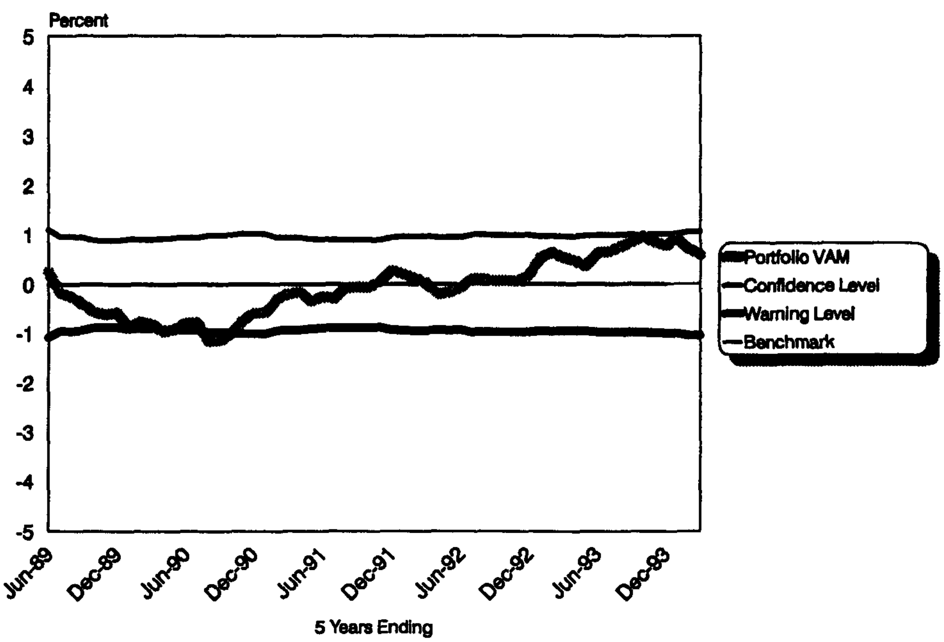
## Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -3.5% | -2.8% |
| Last 1 year | 3.2 | 2.5 |
| Last 2 years | 9.7 | 7.8 |
| Last 3 years | 10.4 | 9.1 |
| Last 4 years | 11.1 | 10.0 |
| Last 5 years | 11.2 | 10.5 |
| Since Inception (7/84) | 12.5 | 12.1 |

## Recommendations

No action recommended.

Investment Advisers
Rolling Five Year Time Periods




Note: Graph uses 80/20 confidence interval.

## MILLER ANDERSON & SHERRERD
**Period Ending 3/31/94**

**Portfolio Manager: Tom Bennett** | **Assets Under Management: $466,063,384**

### Investment Philosophy

Miller Anderson focuses its investments in misunderstood or under-researched classes of securities. Over the years this approach has led the firm to emphasize mortgage-backed and specialized corporate securities in its portfolios. Based on its economic and interest rate outlook, the firm establishes a desired maturity level for its portfolios. Changes are made gradually over an interest rate cycle and extremely high cash positions are never taken. Total portfolio maturity is always kept within an intermediate three-to-seven year duration band. Unlike other firms that invest in mortgage securities, Miller Anderson intensively researches and, in some cases, manages the mortgage pools in which it invests.

### Qualitative Evaluation (reported by exception)

The firms strengths continue to be:

—Highly successful and experienced professionals.

—Extensive securities research process.

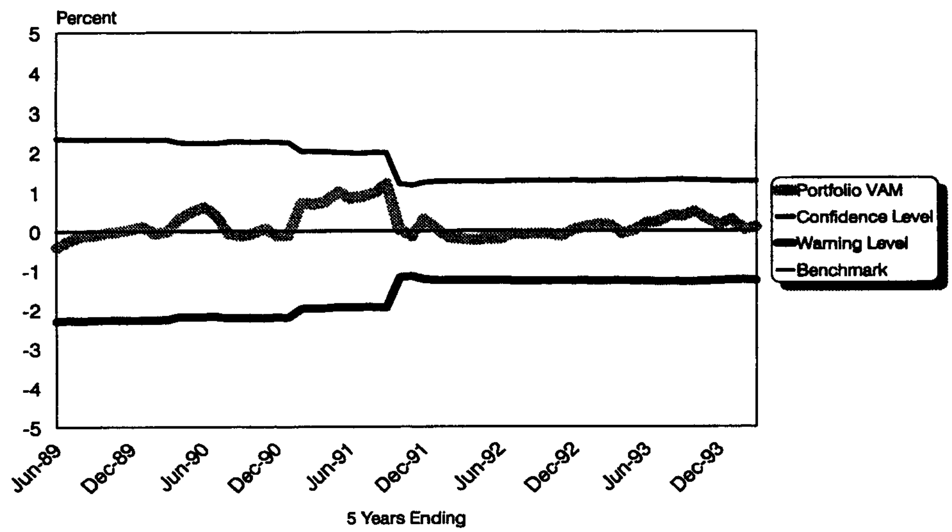
### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -2.9% | -2.8% |
| Last 1 year | 4.2 | 2.5 |
| Last 2 years | 9.3 | 7.8 |
| Last 3 years | 11.0 | 9.1 |
| Last 4 years | 11.5 | 10.0 |
| Last 5 years | 10.7 | 10.5 |
| Since Inception (7/84) | 12.3 | 12.1 |

### Recommendations

No action recommended.

MILLER ANDERSON
Rolling Five Year Time Periods




Note: Graph uses 80/20 confidence interval.

## STANDISH, AYER & WOOD
## Period Ending 3/31/94

**Portfolio Manager: Austin Smith** **Assets Under Management: $458,483,106**

### Investment Philosophy

Standish adds value by capitalizing on market inefficiencies and trading actively through intra and inter-sector swapping. The firm does not forecast interest rates but adds value to the portfolio by buying non-Treasury issues. Key to the approach is active sector trading and relative spread analysis of both sectors and individual issues. In addition to sector spreads, the firm also analyzes how secular trends affect bond pricing. The firm believes that 65% of its value added comes from inter-sector swapping in non-government sectors.

### Qualitative Evaluation (reported by exception)

**Exceptional strengths are:**

—Highly successful and experienced professionals

—Extensive corporate research capabilities.

### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -3.3% | -2.8% |
| Last 1 year | N/A | N/A |
| Last 2 years | N/A | N/A |
| Last 3 years | N/A | N/A |
| Last 4 years | N/A | N/A |
| Last 5 years | N/A | N/A |
| Since Inception (7/93) | -0.3 | -0.2 |

### Recommendations

No action recommended.

**VAM graph will be drawn for period ending 9/30/95**

## TCW
## Period Ending 3/31/94

**Portfolio Manager: Philip Barach** **Assets Under Management: $241,247,853**

### Investment Philosophy

TCW manages a mortgage only portfolio for the SBI. TCW is a mortgage manager that emphasizes security selection. TCW invests a significant portion of the portfolio in collateralized mortgage obligations (CMO's). The staff analyzes various Wall Street models used to evaluate CMO's and determines the validity of their underlying assumptions. They have added significant value by understanding the strengths and weaknesses of these models. This helps them purchase undervalued securities and avoid those that are overpriced.

### Qualitative Evaluation (reported by exception)

**Exceptional strengths are:**

—Highly successful and experienced professionals.

—Extensive CMO investment experience.

### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -1.7% | -2.1 % |
| Last 1 year | N/A | N/A |
| Last 2 years | N/A | N/A |
| Last 3 years | N/A | N/A |
| Last 4 years | N/A | N/A |
| Last 5 years | N/A | N/A |
| Since Inception (7/93) | 1.2 | -0.3 |

### Recommendations

No action recommended.

**VAM graph will be drawn for period ending 9/30/95.**

## WESTERN ASSET MANAGEMENT
## Period Ending 3/31/94

**Portfolio Manager: Kent Engel** **Assets Under Management: $855,677,367**

### Investment Philosophy

Western recognizes the importance of interest rate changes on fixed income portfolio returns. However, the firm believes that successful interest rate forecasting, particularly short run forecasting, is extremely difficult to accomplish consistently. Thus, the firm attempts to keep portfolio maturity in a narrow band near that of the market, making only relatively small, gradual shifts over an intere^st rate cycle. It prefers to add value primarily through appropriate sector decisions. Based on its economic analysis, Western will significantly overweight particular sectors, shifting these weights as economic expectations warrant. Issue selection, like maturity decisions, are of secondary importance to the firm.

### Qualitative Evaluation (reported by exception)

**The firm's exceptional strengths continue to be:**

—Highly successful and experienced professionals.

—Extensive securities research process.

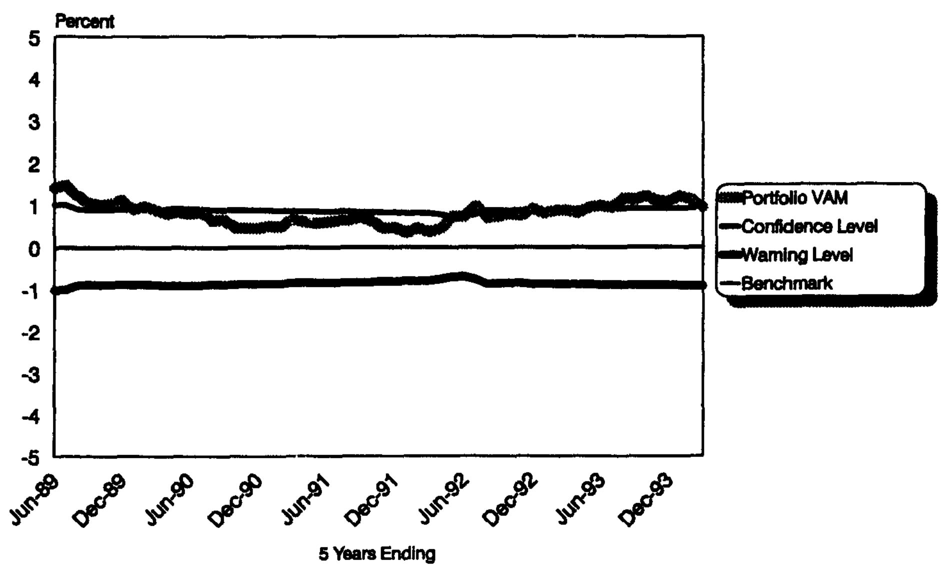
### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -3.3% | -2.8% |
| Last 1 year | 4.9 | 2.5 |
| Last 2 years | 9.7 | 7.8 |
| Last 3 years | 10.9 | 9.2 |
| Last 4 years | 11.5 | 10.1 |
| Last 5 years | 11.7 | 10.5 |
| Since Inception (7/84) | 13.3 | 12.0 |

### Recommendations

No action recommended.

Western Asset Management
Rolling Five Year Time Periods




Note: Graph uses 80/20 confidence interval.

## FIDELITY MANAGEMENT TRUST
## Period Ending 3/31/94

**Portfolio Manager: Tom Steffanci** **Assets Under Management: $1,002,330,408**

### Investment Philosophy

Fidelity is an enhanced index manager who builds an index portfolio using stratified sampling and a risk factor model. Using stratified sampling, Fidelity divides the Salomon BIG into subsectors based on characteristics like maturity, coupon, sector and quality and chooses securities to represent each cell. The portfolio is then compared to the Salomon BIG using a risk factor model. Fidelity adds value to the portfolio through sector selection, issue selection, credit research and yield curve strategies. Fidelity weights sectors based on their relative value and attempts to buy stable credits or credits likely to be upgraded. Finally, Fidelity changes the maturity distribution of the portfolio securities to take advantage of non-parallel shifts in the yield curve.

### Qualitative Evaluation (reported by exception)

**Exceptional strengths are:**

—Highly successful and experienced professionals.

—Extensive securities research process.

—Quantitative capabilities.

**Current concerns are:**

—New portfolio manager as of March 1993. (Former portfolio manager, Sharmin Massavar-Rahmani left to join Goldman Sachs.)

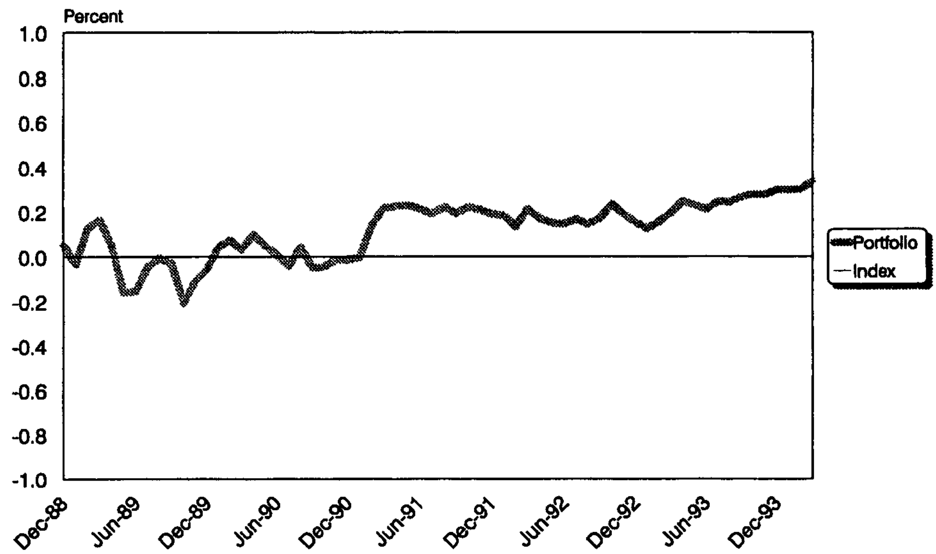
### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -2.5% | -2.8% |
| Last 1 year | 3.6 | 2.5 |
| Last 2 years | 8.5 | 7.8 |
| Last 3 years | 9.6 | 9.1 |
| Last 4 years | 10.5 | 10.0 |
| Last 5 years | 10.9 | 10.5 |
| Since Inception (7/88) | 10.1 | 9.8 |

### Recommendations

No action recommended.

Fidelity Management Trust
Cumulative Annualized Tracking Report



## GOLDMAN SACHS
## Period Ending 3/31/94

**Portfolio Manager: Sharmin Mossavar Rahmani** **Assets Under Management: $1,007,135,342**

### Investment Philosophy

Goldman is an enhanced index manager who focuses on security selection. When analyzing treasuries, the firm models Treasury coupons with an arbitrage based pricing model. This model determines the spread between actual and intrinsic market yields and determines whether the security is rich or cheap. Goldman takes a highly quantitative and analytical approach to value mortgage securities as well. Goldman uncovers undervalued securities using proprietary research and internally developed models. In the corporate sector, Goldman performs its own credit review of each issue. Goldman adds value to the corporate sector with extensive research, market knowledge, and trading skill.

### Qualitative Evaluation (reported by exception)

**Exceptional strengths are:**

—Highly successful and experienced professionals.

—Quantitative capabilities.

### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -2.6% | -2.8% |
| Last 1 year | N/A | N/A |
| Last 2 years | N/A | N/A |
| Last 3 years | N/A | N/A |
| Last 4 years | N/A | N/A |
| Last 5 years | N/A | N/A |
| Since Inception | 0.6 | -0.3 |

### Recommendations

No action recommended.

**Tracking graph will be drawn for the period ending 9/30/95.**

**LINCOLN CAPITAL MANAGEMENT**
**Period Ending 3/31/94**

**Portfolio Manager: Brian Johnson** — **Assets Under Management: $996,843,195**

## Investment Philosophy

Lincoln is an enhanced index manager that uses a quantitative approach to managing the portfolio. Lincoln calculates the index's expected return for changes in 54 variables. These variables include interest rates, yield curve shape, call features and sector spreads. Lincoln then constructs a portfolio to match the expected returns for a given change in any of the variables. Lincoln relaxes the return tolerances, defined as the difference between the portfolio's expected returns and that for the index, for an enhanced index fund. The portfolio's securities are selected from a universe of 250 liquid issues using a proprietary risk-valuation model. A linear program or portfolio optimizer then constructs the most undervalued portfolio that still matches the return characteristics of the index.

## Qualitative Evaluation (reported by exception)

**The firm's strengths are:**

—Highly successful and experienced professionals.

—Extensive quantitative capabilities

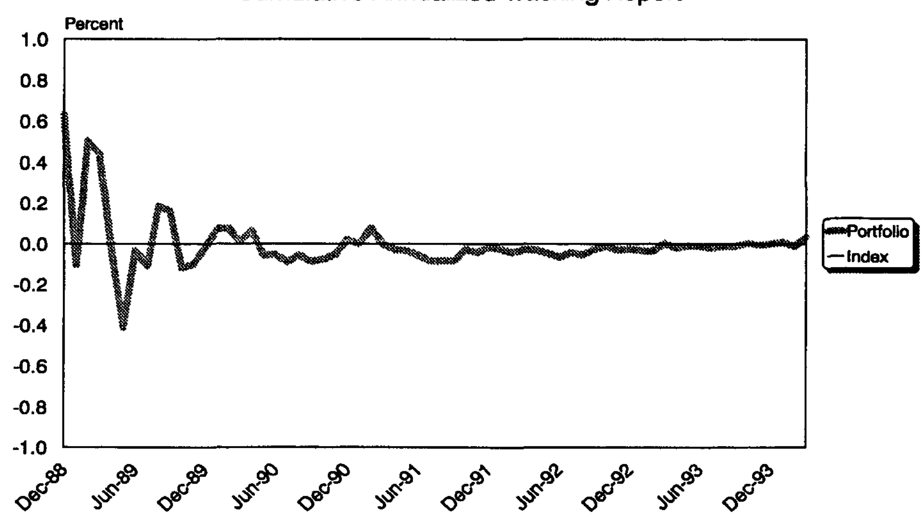
## Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -2.6% | -2.8% |
| Last 1 year | 2.7 | 2.5 |
| Last 2 years | 8.0 | 7.8 |
| Last 3 years | 9.2 | 9.1 |
| Last 4 years | 10.1 | 10.0 |
| Last 5 years | 10.4 | 10.5 |
| Since Inception (7/88) | 9.8 | 9.8 |

## Recommendations

No action recommended.

LINCOLN CAPITAL MANAGEMENT
Cumulative Annualized Tracking Report



# STATE BOARD OF INVESTMENT

## International Manager Evaluation Reports

First Quarter, 1994

## INTERNATIONAL STOCK MANAGERS
## PERIOD ENDING 3/31/94

| Current Managers | Quarter Actual | Quarter Bmk | 1 Year Actual | 1 Year Bmk | Since Inception Actual | Since Inception Bmk | % of Pool | Mkt Value (millions) |
|---|---|---|---|---|---|---|---|---|
| Baring(1) | -3.6% | 3.5% | 22.7% | 22.5% | 22.7% | 22.5% | 9.2% | $177.5 |
| Brinson(1) | -0.2 | 3.5 | 10.2 | 22.5 | 10.2 | 22.5 | 8.4 | 161.4 |
| Marathon(2) | 9.8 | 3.5 | -- | -- | 9.4 | 1.3 | 8.5 | 164.1 |
| Rowe Price(2) | -2.6 | 3.5 | -- | -- | 4.6 | 1.3 | 8.2 | 156.9 |
| Scudder(2) | -3.3 | 3.5 | -- | -- | 1.5 | 1.3 | 8.1 | 155.5 |
| Templeton | 1.3 | 3.5 | -- | -- | 2.9 | 1.3 | 8.2 | 157.4 |
| State Street(3) | 3.3 | 3.5 | 22.1 | 22.5 | 20.1 | 20.3 | 49.4 | 949.0 |
| **Current Aggregate** | **1.6** | **3.5** | **22.0** | **22.5** | **19.9** | **20.3** | **100.0%** | **$1,921.8** |

(1) Active country/passive stock. Retained April 1, 1993
(2) Fully active. Retained November 1, 1993
(3) Index. Retained October 1, 1992

## BARING INTERNATIONAL INVESTMENT LTD.
## Period Ending 3/31/94

**Portfolio Manager: Philip Bullen** | **Assets Under Management: $177,473,145**

### Investment Philosophy

Barings manages an active country/passive stock portfolio for the SBI. Barings' strategic policy team is responsible for the country and currency decisions. Country allocation decisions are made using a macroeconomic framework which seeks to identify growing economies as evidenced by positive changes in GDP and interest rates. The team uses multiple inputs including regional specialists, local market valuations and a computer model that functions as an audit of the qualitative valuation process. Currency specialists within Barings provide assessments on flow of funds, currency rates, monetary policy, inflation and interest rates. Barings uses country index funds managed by State Street Global Advisors to implement their country allocations. At Barings' direction, State Street also implements currency/hedging strategies for the portfolio.

### Qualitative Evaluation
### (reported by exception)

**Exceptional strengths are:**

—Highly successful and experienced professionals.

—Familiar with the needs of large institutional clients.

### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -3.6% | 3.5% |
| Last 1 year | 22.7 | 22.5 |
| Last 2 years | N/A | N/A |
| Last 3 years | N/A | N/A |
| Last 4 years | N/A | N/A |
| Last 5 years | N/A | N/A |
| Since Inception (4/93) | 22.7% | 22.5% |

### Recommendations

No action recommended.

**VAM graph will be drawn for period ending 6/30/95.**

## BRINSON PARTNERS
## Period Ending 3/31/94

**Portfolio Manager: Richard Carr** | **Assets Under Management: $161,444,680**

### Investment Philosophy

Brinson manages an active country/passive stock portfolio for the SBI. The firm uses a proprietary valuation model to rank the relative attractiveness of individual markets based on fundamental considerations. Inputs include forecasts for growth, inflation, risk premiums and foreign exchange movements. Quantitative tools are used to monitor and control portfolio risk, while qualitative judgments from the firm's professionals are used to determine country allocations. Brinson establishes an allocation range around the target index to define the limits of their exposure to individual countries and to assure diversification. Brinson constructs its country index funds using a proprietary optimization system.

### Qualitative Evaluation
### (reported by exception)

**Exceptional strengths are:**

— Highly successful and experienced professionals.

— Familiar with the needs of large institutional clients.

### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -0.2% | 3.5% |
| Last 1 year | 10.2 | 22.5 |
| Last 2 years | N/A | N/A |
| Last 3 years | N/A | N/A |
| Last 4 years | N/A | N/A |
| Last 5 years | N/A | N/A |
| Since Inception (4/93) | 10.2% | 22.5% |

### Recommendations

No action recommended.

**VAM graph will be created for period ending 6/30/95.**

**MARATHON ASSET MANAGEMENT**
**Period Ending 3/31/94**

**Portfolio Manager: William Arah** **Assets Under Management: $164,131,268**

### Investment Philosophy

Marathon uses a blend of flexible, qualitative disciplines to construct portfolios which exhibit a value bias. Style and emphasis will vary over time and by market, depending on Marathon's perception of lowest risk opportunity. Since they believe that competition determines profitability, Marathon is attracted to industries where the level of competition is declining and they will hold a sector position as long as the level of competition does not increase. At the stock level, Marathon tracks a company's competitive position versus the attractiveness of their products or services and attempts to determine whether the company is following an appropriate reinvestment strategy for their current competitive position.

### Qualitative Evaluation (reported by exception)

**Exceptional strengths are:**

—Attractive, unique investment approach.

### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | 9.8% | 3.5% |
| Last 1 year | N/A | N/A |
| Last 2 years | N/A | N/A |
| Last 3 years | N/A | N/A |
| Last 4 years | N/A | N/A |
| Last 5 years | N/A | N/A |
| Since Inception (11/93) | 9.4% | 1.3% |

### Recommendations

No action recommended.

**VAM graph will be drawn for period ending 3/31/96.**

## ROWE PRICE-FLEMING INTERNATIONAL, INC.
## Period Ending 3/31/94

**Portfolio Manager: Martin Wade** **Assets Under Management: $156,939,691**

### Investment Philosophy

Rowe Price-Fleming (RPF) believes that world stock markets are segmented. The firm attempts to add value by identifying and exploiting the resulting pricing inefficiencies. In addition, they believe that growth is frequently under priced in the world markets. RPF establishes its economic outlook based largely on interest rate trends and earnings momentum. The portfolio management team then assesses the country, industry and currency profile for the portfolio. Within this framework, stock selection is the responsibility of regional portfolio managers. Stocks are selected using fundamental analysis that emphasizes companies with above-market earnings growth at reasonable valuations. Information derived from the stock selection process is a key factor in country allocation as well.

### Qualitative Evaluation (reported by exception)

The firms strengths continue to be:

- Extensive securities research process.
- Successful investment approach which has been consistently applied over a number of market cycles.
- Familiarity with the needs of large institutional clients.

### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -2.6% | 3.5% |
| Last 1 year | N/A | N/A |
| Last 2 years | N/A | N/A |
| Last 3 years | N/A | N/A |
| Last 4 years | N/A | N/A |
| Last 5 years | N/A | N/A |
| Since Inception (11/93) | 4.6% | 1.3% |

### Recommendations

No action recommended.

**VAM graph will be created for period ending 3/31/96.**

## SCUDDER, STEVEN & CLARK
## Period Ending 3/31/94

**Portfolio Manager: Nicholas Bratt** **Assets Under Management: $155,479,358**

### Investment Philosophy

Scudder believes that successful international investing requires knowledge of each country's economy, political environment and financial market obtained through continuous and thorough research of individual markets and securities. The investment process focuses on three areas: country analysis, global themes and unique situations. Ideas from all three areas are integrated into Scudder's research universe. Using their own internal research, the firm seeks companies with potential for earnings and dividend growth, strong or improving balance sheets, superior management, conservative accounting practices and dominant position in growing industries.

### Qualitative Evaluation (reported by exception)

**Exceptional strengths are:**

—Strong leadership.

—Extensive securities research capabilities.

—Successful investment approach which has been consistently applied over a number of market cycles.

### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | -3.3% | 3.5% |
| Last 1 year | N/A | N/A |
| Last 2 years | N/A | N/A |
| Last 3 years | N/A | N/A |
| Last 4 years | N/A | N/A |
| Last 5 years | N/A | N/A |
| Since Inception (11/93) | 1.5% | 1 3% |

### Recommendations

No action recommended.

**VAM graph will be drawn for period ending 3/31/96.**

## TEMPLETON INVESTMENT COUNSEL, INC.
**Period Ending 3/31/94**

**Portfolio Manager: Harry Erlich** **Assets Under Management: $157,420,451**

### Investment Philosophy

Templeton's goal is to identify those companies selling at the greatest discount to future intrinsic value. The firm takes a long-term approach to investing and believes that, over time, markets are efficient and patience will reward those who have identified undervalued stocks. Stock selection dominates Templeton's investment approach; country, sector and industry weightings are a residual of the stock selection process. Stock ideas are obtained from a worldwide network of research sources and screens of their own global database. From this preliminary list, analysts conduct fundamental analysis to distinguish a "cheap' stock from a "bargain." Templeton seeks stocks that are cheap relative to their own price history, their global industry and their domestic market. Each stock on the resulting "bargain list" has established buy and sell price targets and is purchased and sold accordingly.

### Qualitative Evaluation (reported by exception)

**Exceptional strengths are:**

—Extensive securities research process.

—Successful investment approach which has been consistently applied over a number of market cycles.

### Quantitative Evaluation

| | Actual | Benchmark |
|---|---|---|
| Last Quarter | 1.3% | 3.5% |
| Last 1 year | N/A | N/A |
| Last 2 years | N/A | N/A |
| Last 3 years | N/A | N/A |
| Last 4 years | N/A | N/A |
| Last 5 years | N/A | N/A |
| Since Inception (11/93) | 2.9% | 1.3% |

### Recommendations

No action recommended.

**VAM graph will be drawn for period ending 3/31/96.**

# Tab E

## COMMITTEE REPORT

DATE: May 31, 1994

TO: Members, State Board of Investment
Members, Investment Advisory Council

FROM: **Alternative Investment Committee**

The Alternative Investment Committee met during the quarter to review the following information and action items:

- Review of current strategy.
- Results of annual review session with an existing private equity manager, The Jacobs Group and an existing real estate manager, Heitman Advisory.
- Investment for the Post Retirement Fund with a new real estate manager, CB Commercial.
- Investment for the Basic Retirement Funds with a new private equity manager, Hellman & Friedman.

### INFORMATION ITEMS:

**1) Review of Current Strategy.**

To increase overall portfolio diversification, 15% of the Basic Retirement Funds and 5% of the Post Retirement Fund are allocated to alternative investments. Alternative investments include real estate, private equity and resource investments where Minnesota State Board of Investment (SBI) participation is limited to commingled funds or other pooled vehicles. A chart summarizing the Board's current commitments is attached (see **Attachment A and B**).

The real estate investment strategy calls for the establishment and maintenance of a broadly diversified real estate portfolio comprised of investments that provide overall diversification by property type and location. The main component of this portfolio consists of investments in diversified open-end and closed-end commingled funds. The remaining portion of the portfolio can include investments in less diversified, more focused (specialty) commingled funds. Currently, the SBI has committed $495 million to nineteen (19) commingled real estate funds.

The private equity investment strategy is to establish and maintain a broadly diversified private equity portfolio comprised of investments that provide diversification by industry type, stage of corporate development and location. To date, the SBI has committed to twenty-six (26) commingled private equity funds for a total commitment of $715 million.

The strategy for resource investment requires that investment be made in resource investment vehicles that are specifically designed for institutional investors to provide an inflation hedge and additional diversification. Individual resource investments will include proved producing oil and gas properties, royalties and other investments that are diversified geographically and by type. Currently, the SBI has committed $113 million to seven (7) commingled oil and gas funds.

2) **Results of Annual Review Sessions with Existing Managers.**

During the quarter, the Alternative Investment Committee and staff attended annual review sessions with one of the SBI's private equity managers, The Jacobs Group and one of the SBI's real estate managers, Heitman Advisory. Overall, the meeting went well and produced no major surprises.

A summary of the review sessions are included as **Attachment C and D** of this Committee Report.

**ACTION ITEMS:**

1) **Investment with a new real estate manager, CB Commercial Advisors in CB Commercial Mortgage Fund II.**

CB Commercial Realty is seeking investors in a new $100-150 million mortgage real estate fund, CB Commercial Mortgage Fund II. The fund will be a follow-on-fund to CB Commercial Mortgage Fund I. Fund I was formed in July 1993 with total investor commitments of $52 million. Like Fund I, Fund II will invest in loans secured by first mortgages on commercial real property, including office, industrial, retail and apartment properties.

More information on CB Commercial Mortgage Fund II is included as **Attachment E.**

**RECOMMENDATION:**

**The Committee recommends that the SBI authorize the Executive Director, with assistance from the SBI's legal counsel, to negotiate and execute a commitment of up to $25 million or 20%, whichever is less, in CB Commercial Mortgage Fund II. This investment will be allocated to the Post Retirement Fund.**

2) **Investment with a new private equity manager, Hellman & Friedman in Hellman & Friedman Capital Partners III.**

Hellman & Friedman is seeking investors in a new $1.0 to $1.5 billion private equity Limited Partnership, Hellman & Friedman Capital Partners III. The fund will be a follow-on fund to Hellman & Friedman Capital Partners I and II. Hellman & Friedman Capital Partners I was formed in 1987 with $327 million in investor capital committed. Hellman & Friedman Capital Partners II was formed in 1991 with $877 million in investor capital committed. Like Funds I and II, Fund III will invest in a broad range of industries both domestically and internationally.

More information on Hellman & Friedman Capital Partners III is included as **Attachment F**.

**RECOMMENDATION:**

**The Committee recommends that the SBI authorize the Executive Director, with assistance from the SBI's legal counsel, to negotiate and execute a commitment of up to $40 million or 20%, whichever is less, in Hellman & Friedman Capital Partners III. This investment will be allocated to the Basic Retirement Funds.**

## ATTACHMENT A

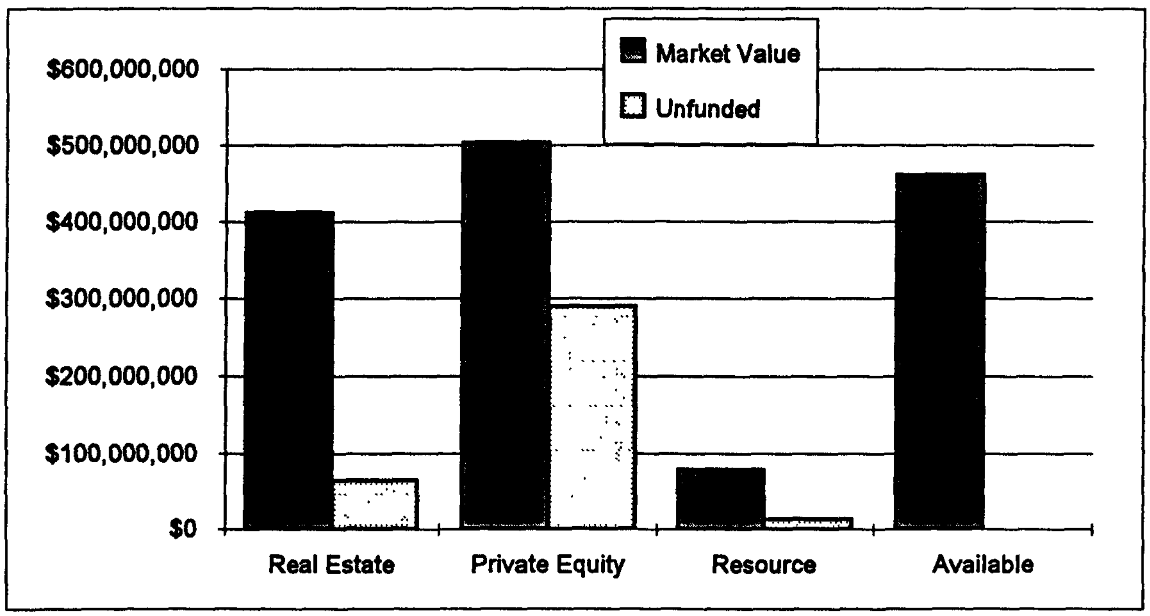
# Minnesota State Board of Investment

*Alternative Investments - Basic Retirement Funds*
*March 31, 1994*

| | |
|---|---|
| Market Value of Basic Retirement Fund (Basic) | $9,697,712,739 |
| Amount Available For Investment | $460,640,958 |

| | *Current Level* | *Target Level* | *Difference* |
|---|---|---|---|
| Market Value (MV) | $994,015,953 | $1,454,656,911 | $460,640,958 |
| MV + Unfunded | $1,361,528,283 | $1,939,542,548 | $578,014,265 |

| Asset Class | Market Value | Unfunded Commitment | Total |
|---|---|---|---|
| Real estate | $411,812,221<br>*4.2%* | $64,562,993<br>*0.7%* | $476,375,214<br>*4.9%* |
| Private Equity | $503,329,705<br>*5.2%* | $289,372,230<br>*3.0%* | $792,701,935<br>*8.2%* |
| Resource | $78,874,027<br>*0.8%* | $13,577,107<br>*0.1%* | $92,451,134<br>*1.0%* |
| Total | $994,015,953<br>*10.3%* | $367,512,330<br>*3.8%* | $1,361,528,283<br>*14.0%* |



# ATTACHMENT A (con't)

**STATE OF MINNESOTA**
**ALTERNATIVE INVESTMENTS - BASIC**
**March 31, 1994**

| | INCEPTION DATE | TOTAL COMMITMENT | FUNDED COMMITMENT | MARKET VALUE | DISTRIBUTIONS | UNFUNDED COMMITMENT | IRR (%) | PERIOD (YEARS) |
|---|---|---|---|---|---|---|---|---|
| ***REAL ESTATE*** | | | | | | | | |
| AETNA 13354 * | Jun-93 | 2,376,529 | 2,376,529 | 2,455,374 | 0 | 0 | 4.44 | 0.8 |
| AETNA | Apr-82 | 40,000,000 | 40,000,000 | 55,196,171 | 0 | 0 | 3.04 | 12.0 |
| AEW III | Sep-85 | 20,000,000 | 20,000,000 | 17,146,576 | 991,948 | 0 | -1.16 | 8.6 |
| AEW IV | Sep-86 | 17,400,000 | 15,000,000 | 4,301,335 | 829 | 2,400,000 | -15.72 | 7.6 |
| AEW V | Dec-87 | 15,000,000 | 15,000,000 | 10,410,233 | 65,593 | 0 | -5.87 | 6.3 |
| AMERICAN REPUBLIC * | Jan-90 | 1 | 1 | 1 | 0 | 0 | 0.00 | 4.2 |
| ARCH STREET CORP. ** | Jul-93 | 10,000,000 | 10,000,000 | 10,000,000 | 0 | 0 | 0.00 | 0.7 |
| EQUITABLE | Oct-81 | 40,000,000 | 40,000,000 | 68,763,897 | 0 | 0 | 4.87 | 12.5 |
| HEITMAN I | Aug-84 | 20,000,000 | 20,000,000 | 11,725,885 | 11,842,633 | 0 | 2.75 | 9.7 |
| HEITMAN II | Nov-85 | 30,000,000 | 30,000,000 | 26,217,266 | 12,189,607 | 0 | 3.89 | 8.4 |
| HEITMAN III | Feb-87 | 20,000,000 | 20,000,000 | 13,601,326 | 5,730,560 | 0 | -0.62 | 7.2 |
| HEITMAN V | Dec-91 | 20,000,000 | 20,000,000 | 21,608,907 | 1,120,134 | 0 | 7.96 | 2.3 |
| LASALLE | Sep-91 | 15,000,000 | 6,554,461 | 6,217,661 | 446,040 | 8,445,539 | 0.93 | 2.6 |
| PAINE WEBBER * | Feb-90 | 500,000 | 500,000 | 333,040 | 94,443 | 0 | -4.01 | 4.2 |
| RREEF | May-84 | 75,000,000 | 75,000,000 | 67,130,699 | 21,306,787 | 0 | 2.33 | 9.9 |
| TCW III | Aug-85 | 40,000,000 | 40,000,000 | 27,668,877 | 10,900,073 | 0 | -0.53 | 8.7 |
| TCW IV | Nov-86 | 30,000,000 | 30,000,000 | 21,893,273 | 2,399,405 | 0 | -3.40 | 7.4 |
| ZELL/MERRILL LYNCH II | Nov-91 | 50,000,000 | 37,482,546 | 38,342,100 | 260,134 | 12,517,454 | 2.74 | 2.4 |
| ZELL/MERRILL LYNCH III | Jan-94 | 50,000,000 | 8,800,000 | 8,799,600 | | 41,200,000 | -3.80 | 0.2 |
| *TOTAL REAL ESTATE* | | *495,276,530* | *430,713,537* | *411,812,221* | *67,348,186* | *64,562,993* | | |
| ***PRIVATE EQUITY*** | | | | | | | | |
| ALLIED | Sep-85 | 5,000,000 | 5,000,000 | 2,957,715 | 3,544,838 | 0 | 5.28 | 8.5 |
| BANK FUND III | Oct-92 | 20,000,000 | 10,000,000 | 10,007,814 | 8,372 | 10,000,000 | -0.39 | 1.4 |
| BLACKSTONE II | Nov-93 | 50,000,000 | 2,816,447 | 2,647,301 | 169,993 | 47,183,553 | -27.49 | 0.4 |
| BRINSON | May-88 | 5,000,000 | 5,000,000 | 3,467,956 | 3,564,049 | 0 | 9.67 | 5.9 |
| BRINSON II | Nov-90 | 20,000,000 | 14,000,000 | 10,776,234 | 10,416,422 | 6,000,000 | 25.80 | 3.3 |
| CHURCHILL II | Oct-92 | 20,000,000 | 8,200,000 | 7,929,994 | 548,133 | 11,800,000 | 3.71 | 1.4 |
| CORAL PARTNERS I (Fomerly SUPERIOR) | Jun-86 | 6,645,000 | 6,312,750 | 7,550,228 | 2,707,667 | 332,250 | 10.35 | 7.8 |
| CORAL PARTNERS II (Formerly IAI II) | Jul-90 | 10,000,000 | 6,500,000 | 7,782,272 | 1,443,401 | 3,500,000 | 11.30 | 3.7 |
| DSV | Apr-85 | 10,000,000 | 10,000,000 | 10,005,933 | 2,528,197 | 0 | 2.83 | 9.0 |
| FIRST CENTURY | Dec-84 | 10,000,000 | 10,000,000 | 7,973,508 | 5,808,419 | 0 | 8.15 | 9.3 |
| GOLDER THOMA III | Oct-87 | 14,000,000 | 11,905,000 | 11,609,121 | 7,956,491 | 2,095,000 | 15.88 | 6.4 |
| GOLDER THOMA IV | Jan-94 | 20,000,000 | 1,600,000 | 1,536,582 | 0 | 18,400,000 | -20.35 | 0.2 |
| IAI I* | Mar-91 | 500,000 | 500,000 | 383,747 | 284,080 | 0 | 11.31 | 3.1 |
| IMR PARTNERSHIP | Aug-92 | 30,000,000 | 248,000 | 1,066,612 | 0 | 29,752,000 | 19.51 | 1.7 |
| INMAN BOWMAN | Jun-85 | 7,500,000 | 7,500,000 | 8,215,996 | 0 | 0 | 1.58 | 8.8 |
| KKR I | Jun-84 | 25,000,000 | 25,000,000 | 46,460,000 | 70,809,719 | 0 | 30.17 | 9.8 |
| KKR II | Apr-86 | 18,365,339 | 18,365,339 | 41,130,000 | 44,259,293 | 0 | 23.00 | 8.0 |
| KKR III | Nov-87 | 145,950,000 | 145,950,000 | 219,170,000 | 104,006,559 | 0 | 11.64 | 6.4 |
| KKR IV | Dec-93 | 150,000,000 | 2,534,000 | 2,534,000 | 0 | 147,466,000 | -83.95 | 0.3 |
| MATRIX II | Aug-85 | 10,000,000 | 10,000,000 | 3,996,423 | 14,928,031 | 0 | 12.82 | 8.6 |
| MATRIX III | May-90 | 10,000,000 | 8,000,000 | 9,584,636 | 497,220 | 2,000,000 | 13.71 | 3.9 |
| NORTHWEST | Jan-84 | 10,000,000 | 10,000,000 | 1,963,996 | 10,411,651 | 0 | 3.11 | 10.2 |
| SUMMIT I | Dec-84 | 10,000,000 | 10,000,000 | 2,876,674 | 14,878,371 | 0 | 11.60 | 9.3 |
| SUMMIT II | May-88 | 30,000,000 | 27,000,000 | 19,085,798 | 31,392,257 | 3,000,000 | 25.27 | 5.9 |
| T.ROWE PRICE | Nov-87 | 47,341,595 | 47,341,595 | 34,106,599 | 21,964,776 | 0 | 21.21 | 6.4 |
| ZELL/CHILMARK | Jul-90 | 30,000,000 | 22,156,573 | 28,510,566 | 2,757,024 | 7,843,427 | 10.12 | 3.7 |
| *TOTAL VENTURE CAPITAL* | | *715,301,934* | *425,929,704* | *503,329,705* | *354,884,963* | *289,372,230* | | |
| ***RESOURCES*** | | | | | | | | |
| AMGO I | Sep-81 | 15,000,000 | 15,000,000 | 6,495,882 | 3,614,536 | 0 | -4.02 | 12.6 |
| AMGO II | Feb-83 | 7,000,000 | 7,000,000 | 7,202,468 | 2,325,453 | 0 | 3.74 | 11.2 |
| AMGO IV | May-88 | 12,300,000 | 12,300,000 | 13,053,322 | 1,508,552 | 0 | 3.84 | 5.9 |
| AMGO V | May-90 | 16,800,000 | 14,535,147 | 16,847,194 | 3,403,869 | 3,403,869 | 11.57 | 3.9 |
| APACHE III | Dec-86 | 30,000,000 | 30,000,000 | 9,070,567 | 35,295,120 | 0 | 11.49 | 7.3 |
| MORGAN OIL&GAS | Aug-88 | 15,000,000 | 13,799,697 | 17,970,618 | 1,280,878 | 1,200,303 | 8.53 | 5.7 |
| SIMMONS OFS | Aug-91 | 17,000,000 | 8,027,065 | 8,233,976 | 450,897 | 8,972,935 | -3.00 | 2.7 |
| *TOTAL RESOURCES* | | *113,100,000* | *100,661,909* | *78,874,027* | *47,879,305* | *13,577,107* | | |
| *TOTAL PORTFOLIO* | | 1,323,678,464 | 957,305,150 | 994,015,953 | 470,112,454 | 367,512,330 | | |

** - Acquired in local police and fire fund consolidation with PERA*
*** - Acquired from Post Retirement Fund as part of asset allocation transition during FY93*

## ATTACHMENT B

# Minnesota State Board of Investment

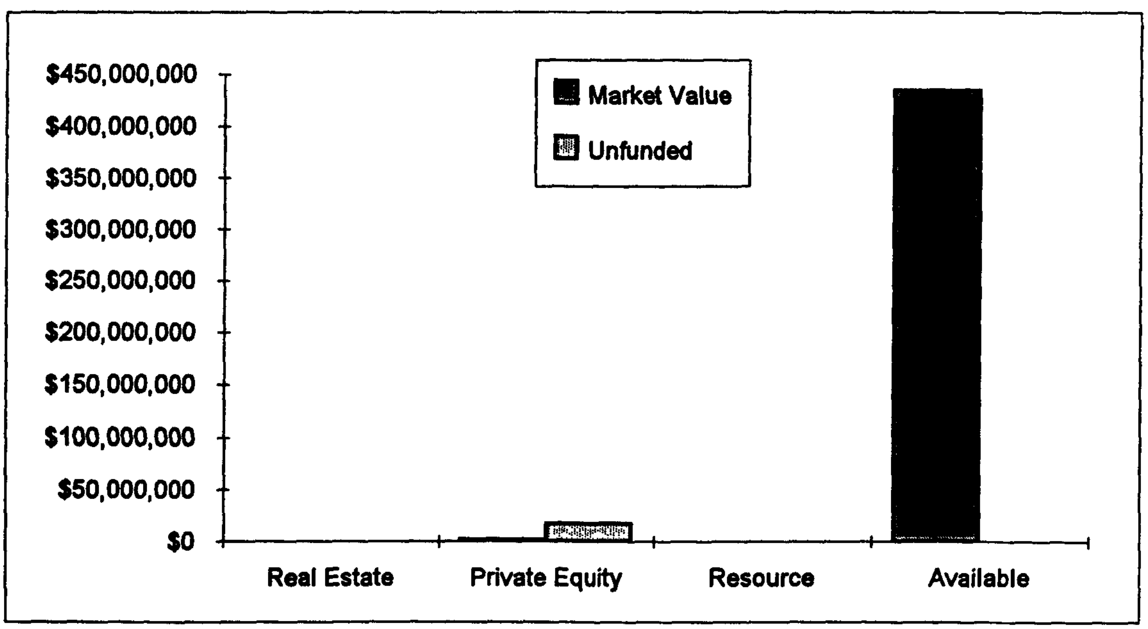
*Alternative Investments - Post Retirement Fund*

*March 31, 1994*

| | |
|---|---|
| Market Value of Post Retirement Fund (Post) | $8,742,518,522 |
| Amount Available For Investment | $435,125,926 |

| | *Current Level* | *Target Level* | *Difference* |
|---|---|---|---|
| Market Value (MV) | $2,000,000 | $437,125,926 | $435,125,926 |
| MV + Unfunded | $20,000,000 | $874,251,852 | $854,251,852 |

| Asset Class | Market Value | Unfunded Commitment | Total |
|---|---|---|---|
| Real estate | $0<br>*0.0%* | $0<br>*0.0%* | $0<br>*0.0%* |
| Private Equity | $2,000,000<br>*0.0%* | $18,000,000<br>*0.2%* | $20,000,000<br>*0.2%* |
| Resource | $0<br>*0.0%* | $0<br>*0.0%* | $0<br>*0.0%* |
| Total | $2,000,000<br>*0.0%* | $18,000,000<br>*0.2%* | $20,000,000<br>*0.2%* |



# ATTACHMENT B (con't)

**STATE OF MINNESOTA**
**ALTERNATIVE INVESTMENTS - POST**
**March 31, 1994**

| | INCEPTIO DATE | TOTAL COMMITMENT | FUNDED COMMITMENT | MARKET VALUE | DISTRIBUTIONS | UNFUNDED COMMITMENT | IRR (%) | PERIOD (YEARS) |
|---|---|---|---|---|---|---|---|---|
| **REAL ESTATE** | | | | | | | | |
| *TOTAL REAL ESTATE* | | ***0*** | ***0*** | ***0*** | ***0*** | ***0*** | | |
| **PRIVATE EQUITY** | | | | | | | | |
| SUMMIT DEBT FUND | Feb-94 | 20,000,000 | 2,000,000 | 2,000,000 | 0 | 18,000,000 | 0.00 | 0.2 |
| *TOTAL VENTURE CAPITAL* | | ***20,000,000*** | ***2,000,000*** | ***2,000,000*** | ***0*** | ***18,000,000*** | | |
| **RESOURCES** | | | | | | | | |
| *TOTAL RESOURCES* | | ***0*** | ***0*** | ***0*** | ***0*** | ***0*** | | |
| *TOTAL PORTFOLIO* | | **20,000,000** | **2,000,000** | **2,000,000** | **0** | **18,000,000** | | |

ATTACHMENT C

**Annual Review Summary**
**IMR Fund, L.P.**
**April 28, 1994**

***Manager Representatives*** Irwin Jacobs, Roger Cloutier

***SBI Assets Under Management*** $1,066,612

### *Background & Description*

IMR Fund L.P., incepted in August 1992, is managed by IMR Management Partners and has $500 million in total investor commitments. The SBI has committed $30 million to the fund. As of March 31,1994, $248 thousand of the SBI's total commitment had been funded. The investment partnership has a ten year term with possible extensions. The investment focus of the fund is to make investments in larger, more mature companies which have under-utilized or under-valued assets and segments and which provide opportunities for financial reorganization, disposition or partial or complete spin-offs.

### *Qualitative Evaluation*

- Deal flow for the fund has slowed over the past year but produced the newest investment opportunity in Kivun Software, Ltd. Kivun is an Israeli based software developer with new technology in multi-language word processing. The fund's investment of approximately $4 million purchased 40% of the company. Mitch Dolson, of IMR, has moved to Jerusalem to manage the interest in the limited partnership. Mitch has a technology background from his experience at the COMB Company as their computer system coordinator.

- The fund's $4 million investment in Bekins Company is progressing well. Bekins may consider an initial public offering for the company within the next year.

- The fund's proposed acquisition of Mayflower Company was not approved by the Board of Directors of Mayflower. The bid for Mayflower was part of a strategy to make Bekins the leader in transporting household goods and other products.

- The IMR Fund acquired from Irwin Jacobs an option to purchase 100% of Jacobs Realty, the corporation which purchased Canterbury Downs. In March 1994, the fund sold its option and will receive approximately $700 thousand.

- In February 1995, the limited partners of the IMR Fund L.P. have the option of rescinding half of their commitment to the fund.

*Quantitative Analysis*

| | |
|---|---|
| **Commitment** | $30,000,000 |
| **Funded Commitment** | $248,000 |
| **Market Value of Funded Commitment** | $1,066,612 |
| **Cash Distributions** | $0 |
| **Inception Date** | August 1992 |
| **Annualized IRR since inception** | 19.51% |

**DIVERSIFICATION PROFILE**
**INVESTMENTS CURRENTLY HELD**

| *Company* | *BUSINESS* | *LOCATION* | *AMOUNT (millions)* |
|---|---|---|---|
| Bekins | Transportation | California | 4 |
| Kivun | Software | Jerusalem, Israel | 4 |
| ***Total*** | | | ***$8*** |

## ATTACHMENT D

**Annual Review Summary**
**Heitman Funds I, II, III, V**
**April 27, 1994**

| | |
|---|---|
| ***Manager Representatives*** | Steve Perlmutter, Andy Deckas, Wendy Good |
| ***SBI Assets Under Management*** | $73,153,384 |

### *Background & Description*

The Heitman Funds I, II, III and V are managed by Heitman Advisory Corporation, whose primary office is in Chicago. Funds I, II, III and V were begun in August 1984, November 1985, January 1987 and July 1991, respectively. The SBI investment commitment totals $90 million for the four Funds. Funds I, II, III and V have been fully funded. Each fund has a fifteen year term. The majority of the funds' investments are equity real estate diversified by property type and location. Heitman Properties Ltd., an affiliate of Heitman, manages the funds' wholly owned properties. Heitman is a subsidiary of United Asset Management.

### *Qualitative Evaluation*

- To date, Heitman has focused on aggressive property leasing in order to increase and maintain occupancies.
- Going forward, Heitman will focus more on preparing a hold/sell analysis of Fund properties in order to provide an orderly liquidation of properties in Funds nearing termination dates. The earliest Heitman Fund, Fund I, terminates in 1999.
- Heitman Funds I, II and III suffered writedowns in 1993 as office and industrial properties were devalued by appraisers. Occupancies for all of the Heitman Funds remain strong, however. Funds I, II, III and V have occupancies of 90%, 88%, 93% and 96% respectively.
- In 1993, Heitman added several new staff members in the research, legal structuring and disposition areas.
- Also in 1993, Heitman became an affiliate of United Asset Management Corporation (UAM), a New York stock exchange listed holding company for institutional investment management companies. Under the terms of the agreement between Heitman and UAM, Heitman will retain complete independence over operating procedures and operating control.

## *Quantitative Evaluation*
*(Through March 31, 1994)*

| | I | II | III | V |
|---|---|---|---|---|
| **Commitment*** | $20 | $30 | $20 | $20 |
| **Funded Commitment*** | $20 | $30 | $20 | $20 |
| **Market Value of Funded Commitment*** | $11.7 | $26.2 | $13.6 | $21.6 |
| **Cash Distributions*** | $11.8 | $12.2 | $5.7 | $1.1 |
| **Inception Date** | Aug-84 | Nov-85 | Feb-87 | Dec-91 |
| **Annualized IRR Since Inception** | 2.75% | 3.89% | -0.62% | 7.96% |

***-All Dollars In Millions***

## DIVERSIFICATION PROFILE

### LOCATION

| | |
|---|---|
| Northeast | 12.60% |
| Midwest | 10.45 |
| Southeast | 12.14 |
| Southwest | 7.22 |
| E.N. Central | 18.13 |
| W.N. Central | 19.05 |
| Mountain | 9.98 |
| Pacific | 10.45 |
| | 100.00% |

### PROPERTY TYPE

| | |
|---|---|
| Office | 28.00% |
| Retail | 57.00 |
| Industrial | 10.00 |
| Mixed Use | 5.00 |
| | 100.00% |

ATTACHMENT E

## REAL ESTATE MANAGER PROFILE

### I. Background Data

| | |
|---|---|
| *Name of Fund:* | CB Commercial Mortgage Fund II |
| *Type of Fund:* | Real Estate Mortgage Group Trust |
| *Total Fund Size:* | $100 - $150 Million |
| *Fund Manager:* | CB Commercial Realty Advisors, Inc.<br>533 South Fremont Avenue<br>Los Angeles, California 90071<br>Phone: (213) 613-3574 |
| *Manager Contact:* | Tim Stevens |

### II. Organization & Staff

The Investment Manager for the Trust (the "Investment Manager") is CB Commercial Realty Advisors, Inc., a wholly-owned subsidiary of CB Commercial

CB Commercial Real Estate Group, Inc. ("CB Commercial") is the successor to the commercial real estate business of Coldwell Banker, the nation's leading commercial real estate services firm. Between 1981 and 1989, Coldwell Banker Commercial was a wholly-owned subsidiary of Sears, Roebuck & Co., which sold the company in 1989. Currently, the firm is substantially owned and controlled by its employees who invested $42.5 million of their own cash in the equity of the company. The remaining equity of the company was contributed by a few private investors. The company has approximately 4000 employees, in 86 offices throughout the country with an office in every major metropolitan area of the United States. In 1993, the company had total revenues of approximately $393 million.

CB Commercial established the Investment Manager as an operating division in 1972 in order to assist pension plans and other tax-exempt investors wishing to make commercial real estate investments. The Investment Manager was separately incorporated in 1983. The Investment Manager has managed eight commingled funds for tax-exempt investors and currently, through six commingled funds and four separate accounts, manages a real estate portfolio that has a value of approximately $800 million. The Investment Manager also manages CB Commercial Mortgage Fund, a commingled fund, on behalf of tax-exempt investors, which was closed in December, 1993, and is in the process of identifying and originating mortgage loans for investment by such fund.

The Investment Manager will appoint CB Commercial Mortgage Banking to originate loans and perform selected servicing activities. Mortgage Banking provides mortgage origination, loan underwriting, and loan administration services to institutional real estate lenders throughout the United States. Mortgage Banking serves as the exclusive origination correspondent for a number of major institutional investors. Mortgage Banking, which was established in 1939, originates mortgage loans only on commercial real estate. Mortgage Banking employs approximately 75 employees located in sixteen major metropolitan areas throughout the United States. For the last ten years, Mortgage Banking placed on behalf of institutional investors an average of approximately $1.0 billion in mortgage loans annually. Mortgage Banking currently provides collection and loan administration services for a loan portfolio of approximately $3.4 billion originated by Mortgage Banking.

Organizational review of loans will include:

- Every loan submission will be reviewed and recommended by a Regional Manager from Mortgage Banking.
- The property securing any proposed loan will be appraised by an independent M.A.I. appraiser. Then, a separate appraiser who is a member of the staff of Realty Advisors will check the independent appraiser's conclusions to verify value.
- The underlying real estate securing every loan will be inspected by a CB Commercial management level person.
- Every loan will be reviewed and analyzed by the Director of Mortgage Lending of Realty Advisors, Timothy Stevens.
- A committee of senior officers of Realty Advisors will review and recommend every loan.
- The Investment Committee of the Capital Markets Group will have final decision making authority on whether the Fund makes any loan. The Investment Committee is comprised of some of the most senior officers of CB Commercial.
- Realty Advisors has access to and will utilize the exclusive resources of Torto Wheaton Research to evaluate market risk. Torto Wheaton maintains a database of historical information on the national real estate market, specific submarkets, individual buildings, and specific tenants.

## *III. Investment Strategy*

The investment objective of the Trust is to make loans of $1 million to $10 million secured by first mortgages on commercial real property, including office, industrial, retail, and apartment properties. The terms of such loans will be not less than five, nor more than ten, years. Interest will accrue on the Mortgage Loans at a fixed rate of interest agreed by the Investment Manager and the borrower. The Investment Manager believes that it will be able to place Mortgage Loans carrying rates of interest of approximately 2.0% to 3.0% per annum over the market yield for United States Treasury obligations of similar maturities. In addition, Mortgage Banking will not recommend that a Mortgage Loan be extended unless, based on financial information provided, (a) the "debt service coverage ratio" initially equals or exceeds 1.20, and (b) the "loan to value ratio" equals or is less than 0.75. To the extent permitted by applicable laws, the loan agreement for each Mortgage Loan will contain provisions that would require the borrower to pay a prepayment premium of one percent of the amount prepaid or an amount determined under a "yield maintenance provision," whichever is greater, in the event such borrower elects to prepay such Mortgage Loan, or portion thereof, more than 90 days prior to maturity. The Mortgage Loans will be non recourse to the borrowers, except as to fraud, willful misconduct, and liability under environmental laws.

## *IV. Investment Performance*

CB Commercial's first mortgage fund, CB Commercial Mortgage Fund I was established July 1, 1993. Six investors committed a total of $52 million to Fund I. In the nine months since inception of the Fund, CB Comercial has closed three loans, committed to three more loans and has under application additional loans. The nine loans together represent $29.1 million of loans or 56% of total fund commitments. The loans are diversified by property location and type and each loan is under $10 million in size. Rates vary from 8.75% to 9.125% which represent spreads over comparable treasury securities in excess of 300 basis points. Loan to property value ratios vary from 35% to 72%. Also, debt service coverage varies from 2.50 times to 1.34 times on the loans.

## *V. Term*

The Fund is a closed end investment vehicle. The individual mortgages will have terms of 5 to 10 years. Therefore, when the last loan matures, the Fund will cease to exist.

## *VI. Distributions and Fees*

Upon receipt by the Trust of the proceeds of the initial call for payment of subscriptions for Units, the Trust will pay the Trustee an initial fee of $7,500, and will reimburse the Trustee for its direct expenses incurred in the organization of the Trust (including legal fees and expenses). In addition, the Trust will pay the Investment Manager an amount equal to 2.0% of the aggregate amount of subscriptions (the "Subscription Fee"). The Subscription Fee will be used by the Investment Manager to pay the fees and expenses of an affiliate for loan origination and loan application review services and to compensate the Investment Manager for reviewing, approving, and placing the loans. Prospective borrowers from the Trust will be required to pay certain fees to the Trust, which the Investment Manager believes will total approximately 1.5% of the aggregate amount of subscriptions. For example, if the Trust is fully subscribed at $100 million, $2 million of the proceeds from such subscriptions received by the Trust will be paid by the Trust to the Investment Manager. If the Trust is fully invested in Mortgage Loans, the aggregate amount invested should be approximately $99.5 million (i.e., $98 million net proceeds from subscriptions plus approximately $1.5 million from fees paid to the Trust by borrowers), less the Trustee's initial fee and reimbursement of expenses.

The Trustee will also receive a quarterly administration fee from the Trust of one-fourth of (a) 0.0175% of the first $50 million of assets held by the Trust at the beginning of such quarter, (b) 0.0075% of the assets held by the Trust on such date in excess of $50 million and less than or equal to $100 million, and (c) 0.0050% of the assets held by the Trust on such date in excess of $100 million.

The annual management and loan servicing fee shall be .35% (35 basis points) of the total capital invested in mortgages. The management fee will pay for portfolio management, loan servicing, investor reporting, relations, management and disposition of foreclosed assets, if any.

The Investment Manager will be paid a Performance Fee, upon liquidation of the Fund, of .35% of the aggregate capital invested in mortgage loans. The Performance Fee will be reduced by any losses from the expected returns to Investors. The Performance Fee is completely at risk until the Investors have received all their agreed upon principal and interest payments.

Returns from Fund investments will be distributed monthly.

## *VII. Takedown Schedule*

The Investment Manager will have the discretion to call any subscriptions at any time it deems appropriate. Payment for a Participant's Units will generally be required two weeks after it receives a notice to that effect from the Investment Manager.

ATTACHMENT F

# PRIVATE EQUITY MANAGER PROFILE

## I. Background Data

| | |
|---|---|
| ***Name of Fund:*** | Hellman & Friedman Capital Partners III |
| ***Type of Fund:*** | Private Equity Limited Partnership |
| ***Total Fund Size:*** | $1.0 billion to $1.5 billion |
| ***Fund Manager:*** | Hellman & Friedman<br>One Maritime Plaza<br>San Francisco, CA 94111<br>Phone (415) 788-5111<br>Fax (415) 788-0176 |
| ***Manager Contact:*** | John Pasquesi |

## II. Organization & Staff

Hellman & Friedman (H&F) was organized in 1984 as a Californian general partnership and currently have offices in San Francisco, Hong Kong and Sydney. The partners of H&F are F. Warren Hellman, Tully M. Friedman, Matthew R. Barger, John M. Pasquesi, John L. Bunce, Jr., Marco W. Hellman, Thomas F. Steyer, Mitchell R. Cohen, Joseph M. Niehaus and Georgia Lee. In addition to the partners listed above, H&F has four other non-partner investment professionals. From 1984 to 1987 H&F invested the partners' capital in special situation investments and provided investment banking services to a variety of clients. Most noteworthy was the firms involvement in the buyout of Levi Strauss & Co.

In 1987 H&F raised Hellman & Friedman Capital Partners I with total committed capital of $327 million. In 1991 H&F raised Hellman & Friedman Capital Partners II with total committed capital of $877 million. Through 1993 H&F has invested, or committed to invest, $615 million (70%) of their most recent fund.

While the preponderance of time has been devoted to principal investing, H&F has served as a financial advisor to a selected number of clients. Currently H&F serves as financial advisor only to Levi Strauss & Co. and The Clorox Company. The approval of the Advisory Board of Hellman & Friedman Capital Partners III will be required to enter into any additional financial advisory relationships.

## *III. Investment Strategy*

The principals maintain an opportunistic investment approach and believe that focusing their activities in certain industries helps produce better deal flow. The principals spend a substantial amount of time identifying attractive industries where companies have strong franchises, attractive growth prospects, and high levels of expected free cash flow relative to capital employed in the business. Additionally, the ability to focus on specific industries helps H&F to generate more investment opportunities, respond more quickly, be more active, and raise outside capital more efficiently.

H&F also employs their opportunistic approach and industry focus to international investments. Typically H&F international investments are done as a joint venture or side-by-side an indigenous firm or individual. It is expected that between 30% to 50% of the fund currently being raised will be invested internationally.

## *IV. Investment Performance*

Hellman & Friedman Capital Partners I was formed in 1987 with $327 million in equity capital committed but halted drawdowns at $167 million to raise a larger fund. Most of the unused commitments in fund I were rolled over into fund II. Today the portfolio is fully invested with a carrying value of $172 million and has distributed $62 million of capital back to investors. This corresponds to a 8.65% net IRR to investors. Using competitive cash flow, book value, and other market valuation multiples, H&F feels the current portfolio valuation is significantly in excess of reported valuations.

Hellman & Friedman Capital Partners II was formed in 1991 with $877 million in equity capital committed. As of March 31, 1994, the fund has invested $455 million, carries a value of $455 million, and has distributed $78 million of capital back to investors. The net IRR to investors is 5.93% with nearly all investments carried at cost.

## *V. General Partners Investment*

The General Partner will make a capital contribution of $50 million.

## *VI. Takedown Schedule*

Contributions are payable upon 10 calendar days' written notice by the general partner. Each contribution will be for a minimum of $25 million in aggregate from all partners. In no event will capital contributions be called prior to the first investment or after the fifth anniversary of the formation date.

## VII. *Management Fees*

1.5% of committed capital (subject to reduction related to any investment banking fees). Upon the formation of a subsequent equity partnership or the end of the commitment period, the management fee will be reduced to 0.75% of the then current cost of investment held by the partnership.

## VIII. *Term*

Ten years, extendible by up to two years by the general partner.

## IX. *Distributions*

Gains and losses on investments will be allocated to the partners in proportions to the partners' respective participating interests in each investment. Profits of the partnership will be allocated 80 percent to the partners and 20 percent to the general partner. Profits will consist of income and gains net of all losses, management fees and partnership expenses. Until cumulative profits exceed cumulative losses, items of income and loss will be allocated to the partners in proportion to their interests in each investment.

In the normal course of business, realized net profits will be fully distributed, in proportion to the partners' interests in each investment, subject to any appropriate reserves. Profits and losses from investments realized in any calendar year will be netted before any distribution is made to the general partners

## X. *Re-Use of Capital*

To the extent investments are liquidated during the commitment period, capital (but not profits) will be available for future call and reinvestment during the commitment period.

# Tab F

# STATE OF MINNESOTA
## OFFICE OF THE STATE TREASURER

303 State Administration Building
50 Sherburne Avenue
Saint Paul, Minnesota 55155

MICHAEL A. McGRATH
Treasurer

(612) 296-7091
Fax (612) 296-8615


DATE: May 31, 1994

TO: Members, State Board of Investment

FROM: Michael A. McGrath, Chair
SBI Administrative Committee

SUBJECT: **Committee Report**

The SBI Administrative Committee met on May 26, 1994 and took action on the following items:

**1) Executive Director's FY95 Workplan**

Mr. Bicker presented his proposed workplan for FY95. Like the previous workplans, the FY95 plan follows the same category order found in the Executive Director's position description. The plan is a compilation of on-going responsibilities as well as the new initiatives the Executive Director will undertake during the next year.

A summary of the proposed plan is shown in **Attachment A**. Supporting information was sent to each Board member as part of the FY95 Management and Budget Plan document.

**RECOMMENDATION:**

**The Committee recommends that the SBI approve the FY95 Executive Director's Workplan. Further, the Committee recommends that the workplan serve as the basis for the Executive Director's performance evaluation for FY95.**

**2) FY95 Administrative Budget Plan**

The SBI's Administrative budget is funded by a legislative appropriation from the general fund. All expenditures are billed backed to the various funds under the supervision of the SBI and the receipts are deposited in the general fund as non-dedicated revenue.

An overview and summary of the budget is in **Attachment B**. Supporting information was sent to each Board Member as part of the FY95 Management and Budget Plan.

**RECOMMENDATION:**

**The Committee recommends that the SBI approve the FY95 Administrative Budget Plan.**

**3) Fiduciary Education Plan**

Minnesota Statutes Chapter 356A requires each public pension plan to establish a continuing education plan for its fiduciaries. The plan approved by the Committee is in **Attachment C**. Please note that the travel allocation policy for Board members and their designees is included in the plan.

**RECOMMENDATION:**

**The Committee recommends that the SBI adopt the attached Continuing Fiduciary Education Plan.**

**4) Process for Executive Director's FY94 Evaluation**

The Committee discussed the process that will be used by the Board to evaluate the Executive Director for FY94. The Committee members agreed that the performance reviews should be completed prior to the September 1994 meeting of the SBI and should follow the process used in the past.

**RECOMMENDATION:**

**The Committee recommends that the SBI adopt the following process for the Executive Director's FY94 performance evaluation:**

- **The evaluation will be completed prior to the September 1994 meeting of the SBI.**
- **The evaluation will be based on the results of the Executive Director's workplan for FY94.**
- **The SBI deputies/designees will develop an appropriate evaluation form for use by each member.**

- **As the chair of the Board, the Governor, or his representative, will coordinate distribution and collection of the evaluation forms and will forward the completed forms to the Executive Director. Board Members are encourage to meet individually with the Executive Director to review their own evaluation.**

**5) Approval of Preliminary FY96-97 Biennial Budget Request**

As a state agency, the SBI's administrative budget is part of the State's biennial budget process. All state agency budget requests for FY96-97 will be developed over the summer and fall under the guidelines issued by the Department of Finance. The resulting Governor's budget proposal will be presented to the Legislature in early 1995.

Mr. Bicker reviewed an outline of the preliminary budget request in **Attachment D** with the Committee. After discussion, the Committee recommended that Mr. Bicker proceed with the budget submission process using this preliminary data. If Mr. Bicker finds it necessary to make significant changes, the Committee will reconvene to provide input.

**RECOMMENDATION:**

**The Committee recommends that the SBI authorize the Executive Director to develop a FY96-97 biennial budget based on the preliminary information in Attachment D and subject to any future budget guidelines issued by the Department of Finance. If significant changes are deemed necessary by the Executive Director, he should review them with the SBI Administrative Committee prior to submission to the Department of Finance.**

**6) Amendment to Custody Contract**

The current custody contract with State Street Bank (SSB) requires that SSB provide unit values for all SBI Pooled Investment Accounts and the Supplemental Investment Fund accounts by the close of the sixth business day after month end. This time frame for valuing pools has been in place for ten years and reflects the capabilities of the custodian to provide the information and the needs of the users at that time.

Changes in the reporting time frames of the various users of this information now require more timely valuations. Current technology enables SSB to provide unit values as early as the morning after month end. The advantages of implementing next morning unit value pricing of the SBI Pooled Investment Accounts and the Supplemental Investment Fund are:

- Asset allocation rebalancing decisions will be based on current market values. Currently due to the complexity of the SBI's management structure, the necessary valuation data is not available until mid month. One day pricing will increase the effectiveness of the SBI's rebalancing policy.

- The turn around time on accounting and performance measurement data will be reduced by at least one week each month. This will enhance the SBI's ability to provide timely information to the Board, IAC and other constituents.

- Participants will be able to move assets in and out of the Supplemental Investment Fund within two to four days after the close of the month rather than the current two to three weeks. This makes the Fund more responsive and flexible for its users.

The cost for this improved service is estimated at $600,000 per year. SSB will use the increased fee to pay for the additional pricing information and additional staff necessary to provide the increased level of service.

While this is a significant increase, SSB would implement one day pricing for the SBI without impacting the "zero net fee" provision of the current contract. This means that SSB will guarantee the additional costs will continue to be totally offset by the securities lending income generated by SSB for the SBI's account.

Through its securities lending activity, SSB was expected to generate net income of $3.9 million over the life of current contract. If the one-day pricing amendment is approved, net income to the SBI would be reduced. However, securities lending income would still be expected to result in approximately $1.5 million credited to SBI funds over the life of the contract.

**RECOMMENDATION:**

**The Committee recommends that the SBI authorize the Executive Director, with assistance from SBI legal counsel, to negotiate and execute a contract amendment with State Street Bank and Trust Company to provide one day pricing for assets custodied at State Street provided that the amendment does not impact the "zero net fee guarantee" provision of the existing contract.**

## 7) International Investing Guidelines

In September 1992, the SBI established an International Investing Guidelines Task Force. Its charge was to make recommendations to the Board concerning issues related to human rights, worker rights and environmental concerns with respect to the Board's international investment program. The report of the Task Force was adopted in December 1992 and the guidelines have been incorporated in the implementation of the international program since that date.

The Task Force has not met since its report was presented to the Board in December 1992. Its seventeen (17) members included: a representative of each Board member, a representative of each of the three statewide retirement systems, two private sector representatives of the Investment Advisory Council, two representatives from organized labor, one representative from environmental groups, the SBI's executive director and the SBI's international consultant. By statute, an advisory task force expires within two years unless it is expressly reauthorized by the appointing authority.

***Policy Guidelines***

The Task Force focused on information available from country reports compiled annually by the US State Department. Based on that information, the Task Force recommended a policy framework which grouped countries into three broad categories. *It is important to note that the guidelines do not prohibit a manager from investing in the market of any country.* Rather, they require either written notification or personal presentation from the manager in certain cases:

**Group 1**: According to the US State Department reports, these countries have legal protections or practices that generally respect internationally recognized worker and human rights. As a result, there is little concern that economic and social disruptions may occur which would have an adverse effect on financial markets. No additional notification or presentation is required regarding a manager's decision to invest in the market of any of these countries.

**Group 2**: These countries have legal protections for worker and human rights but violations of these rights have been cited in the US State Department reports. Because violations of legally protected rights continue to occur in these countries, there is some concern that economic and social disruptions may occur which may have an adverse effect on their financial markets. If a manager chooses to invest in one of more of these markets, the manager must notify the SBI in writing of the decision to do so.

**Group 3**: According to US State Department reports, these countries appear to lack basic protections for worker and human rights and do not appear to be making adequate progress in establishing a legal structure to address these issues. As a result, the potential for economic, social and political unrest exists which could adversely affect the stability of the financial markets within these countries. If a manager chooses to invest in one or more of these markets, the manager must appear at a meeting of the SBI to present its reasons for the decision to do so.

The country groupings developed by the Task Force in late 1992 is in **Attachment E**.

***Results To Date***

The SBI's active international stock managers have invested the SBI's portfolios in the following "Group 2" countries: Argentina (3 managers), Brazil (2 managers), Chile (1 manager), India (1 manager), Korea (2 managers), Malaysia (6 managers), Mexico (5 managers), Thailand (3 managers). In each case, the managers provided the required written notification of the decision to invest in the market. According to staff's discussions with the managers, each manager is investing in "Group 2" markets to the same extent that they are investing in these markets for other clients with similar mandates.

One of the SBI's active managers has chosen to invest the SBI's portfolio two "Group 3" markets (South Africa and Indonesia). The investments were made very recently and the manager is prepared to present its reasons for making the investments at the convenience of the SBI. The manager has informed staff that they are making the same investments for all of their clients with similar mandates. While they have not yet done so, several other managers have stated that they may invest in either or both of the same countries in the future.

Some of the managers have expressed interest in investing in one or more markets that were not included in any group in the December 1992 Task Force report. This points out that the original list will need to be expanded from time to time as new markets become viable candidates for investment.

***Proposed Review Process***

When the Task Force made its report to the Board, the Task Force assumed that the country groupings would be updated periodically to reflect changes in the world markets. While the SBI could reconvene the Task Force for this purpose, the Committee believes that a slightly different review process can be administered more efficiently. An outline of the proposed process follows:

- The Task Force should be reauthorized and extended to review or propose any changes to the existing policy guidelines. Any recommended changes to the policy guidelines would be sent to the Board for action. (At this time, no change is contemplated.)

- Staff would review new reports from the US State Department against the worker and human rights issues highlighted by the Task Force in its December 1992 report to the SBI. Staff would designate countries as "Group 1, 2 or 3" using the existing policy guidelines adopted by the Board.

- Staff designations would be reviewed with SBI Administrative Committee. This would include any movement of countries between categories as well as categorizations of any new markets that need to be added to the list of available markets. The groupings would be reported to the Board as an information item in the Administrative Committee report since it is implementation of a policy that has already been adopted by the Board.

- Active international stock managers would continue to provide written notification to SBI of the manager's decision to invest in any "Group 2" market(s).

- Active international stock managers would be required to appear before a meeting of the SBI Administrative Committee to explain their decision to invest in any "Group 3" market. This may require special meetings of the Committee to be convened on an "as needed" basis. The Committee would report to the Board on the results of such meetings as an information item.

This proposed process uses the same policy framework established by the Task Force and adopted by the Board. Board designees and IAC members would be consulted in the review process because they are represented on the SBI Administrative Committee. Organized labor would not be involved in the on-going implementation process but would be represented in any recommendation concerning changes in the policy guidelines/review criteria.

**RECOMMENDATION:**

**The Committee recommends that:**

- **The SBI reauthorize and extend the International Investing Guidelines Task Force with its current membership for an additional two year period. The Task Force should reconvene, as needed, to consider changes to the policy guidelines. Any recommended changes will be presented to the Board for approval.**

- **SBI staff will designate countries as "Group 1, 2 or 3" using the policy guidelines adopted by the Board. The designations will be based on the country reports published annually by the US State Department.**

- **Staff designations will be reviewed with SBI Administrative Committee. This will include any movement of countries between categories as well as categorizations of any new markets that need to be added to the list of available markets.**

- **The SBI's active international stock managers will be required to provide SBI staff with written notification of their decision to invest in the market of any "Group 2" country.**

- **The SBI's active international stock managers will be required to appear before a meeting of the SBI Administrative Committee to explain their decision to invest in any "Group 3" country.**

- **Results will be reported periodically to the Board as an information item in future reports of the SBI Administrative Committee as implementation of a policy that has already been adopted by the Board.**

**8) Deferred Compensation Contracts**

At the March 1994 meeting of the SBI, Mr. Bicker and Mr. Bergstrom, MSRS Executive Director, reported on their progress in re-negotiating the terms of the existing contracts with the insurance companies and marketing organizations involved with the Deferred Compensation Plan. At that time, the Board urged Mr. Bicker and Mr. Bergstrom to continue their negotiations and bring final contracts to the Board for consideration at the June 1994 meeting.

The SBI Administrative Committee has reviewed the proposed contracts with the insurance companies (Great-West and Minnesota Mutual) and the service or organizations (National Benefits and Ochs Services). A summary comparison of the existing and proposed contracts is in **Attachment F**. The contract documents are copied in full in the material labeled "Addendum to the Meeting Materials for June 8, 1994: Proposed Deferred Compensation Contracts."

The SBI Administrative Committee concurs with Mr. Bicker's assessment that the proposed contracts contain substantial improvements for Deferred Compensation Plan participants since they will both increase investment flexibility participants and reduce overall costs. As a result, the Committee recommends that the SBI approve all the contracts as presented.

**RECOMMENDATION:**

**The Committee recommends that the SBI approve the contracts with Great-West Life, Minnesota Mutual Life, National Benefits, Inc. and Ochs Services Agency contained in "Addendum to the Meeting Materials for June 8, 1994: Proposed Deferred Compensation Contracts" and authorize the Executive Director to execute the contracts.**

ATTACHMENT A

# STATE BOARD OF INVESTMENT

## Executive Director's Proposed Workplan

## FY95

**(Categories A, B, C, D, E correspond to the position description)**

| **A. DEVELOPMENT OF INVESTMENT POLICIES** | **Projected Time Frame** |
|---|---|
| 1. Develop alternative management structure using a guaranteed investment contract pool for the Fixed Interest Account in the Supplemental Investment Fund (SIF). | Jul. - Sep. |
| 2. Develop semi-passive management segment within the domestic equity program. | Jul. - Mar. |
| 3. Review the program structure/vendors used by the College Plans for their Individual Retirement Account Plan (IRAP) programs. | Sep. - Jun. |
| 4. Review investment policy of the Permanent School Fund. | Jul. - Jun. |

**B. IMPLEMENTATION OF INVESTMENT POLICIES APPROVED BY THE SBI**

| | |
|---|---|
| 1. Meet or exceed the performance objectives established for the Basics, Post, and Combined Funds. | On-going, reported quarterly |

- Obtain returns that are 3-5 percentage points over inflation over the last 10 years (FY86-FY95) for the Combined Funds.
- Outperform the median fund from the TUCS universe of Master Trusts over the last 5 years (FY91-FY95) for the Combined Funds.

- Outperform a composite of market indices over the last 5 years (FY91-FY95). Separate composites are constructed for the Combined, the Basics and the Post Funds.

| | |
|---|---|
| 2. Implement Manager Monitoring Programs for domestic stocks, international stocks and domestic bonds. | On-going |
| 3. Consider additional investments with new/existing alternative investment managers. | On-going |

**C. REVIEW AND CONTROL OF INVESTMENT POLICIES**

| | |
|---|---|
| 1. Monitor and evaluate active manager performance in accordance with the SBI's Manager Continuation Policy. | On-going |
| 2. Review investment guidelines for stock and bond managers on an annual basis. | Apr. - Jun. |
| 3. Monitor implementation of Northern Ireland mandate. | On-going |
| 4. Monitor implementation of the Board's guidelines on international investing. | On-going |
| 5. Monitor implementation of proxy voting procedures. | On-going |
| 6. Provide staff support for initiatives assigned to the Proxy Committee. | As needed |

**D. ADMINISTRATION AND MANAGEMENT OF STAFF OPERATIONS**

| | |
|---|---|
| 1. Cooperate in all respects with the annual audit of SBI operations by the Legislative Auditor. | Jul. - Dec. |
| 2. Prepare and seek approval of the SBI's legislative proposals for 1995 Legislative Session, if needed. | Oct. - May |

| | |
|---|---|
| 3. Prepare and seek approval of the SBI's administrative budget for FY96-97. | Aug. - May |
| 4. Prepare FY96 Management and Budget Plan. | Mar. - Jun. |
| 5. Coordinate police and fire fund consolidations. | As needed |
| 6. Respond to growing interest from local police and fire funds to invest through the Supplemental Investment Fund. | Jul. - Jun. |

## E. COMMUNICATION AND REPORTING

| | |
|---|---|
| 1. Prepare reports on investment results. | Quarterly |
| 2. Prepare status reports on the Executive Director's FY95 workplan for review by the SBI, IAC and Consultant, as requested. | As requested |
| 3. Meet with the SBI and IAC on a quarterly basis and at other times as required. | Quarterly, or as requested |
| 4. Meet with the Board's designees on a monthly basis, as requested. | Monthly, or as requested |
| 5. Prepare FY94 Annual Report. | Jul. - Feb. |
| 6. Coordinate round table discussions with SBI's external managers. | Periodic, 2-3 per year |

ATTACHMENT B

## Administrative Budget
## FY95 Budget Plan
## Overview

The FY95 budget plan is based on the SBI's FY94-95 Biennial Budget.

| | FY94 PROJECTED | FY95 PLAN | DIFFERENCE |
|---|---|---|---|
| Personnel | $1,440,140 | $1,505,500 | $+65,160 |
| Contractual Services | 383,210 | 396,750 | +13,540 |
| Operating Expenses | 77,000 | 77,000 | -0- |
| Supplies and Equipment | 92,600 | 64,500 | -28,100 |
| | $1,992,950 | $2,043,550 | $+50,600 |

**Personnel Costs:** Salaries, retirement, insurance, FICA, severance

Personnel costs in FY95 will be approximately $65,160 or 4.5% higher than the amount projected for FY94. The increased costs are due to the July 1, 1994 cost of living increases negotiated for all state employees (generally 3.25%), associated cost increases for retirement and FICA, higher insurance costs and normal progression increases that are part of union contracts.

**Contractual Services:** Rents, leases, printing, data processing

Contractual services expenditures will be approximately $15,540 higher than in FY94. Increased costs for office space lease, printing costs and professional/technical service contracts make up most of this expected increase.

**Operating Expenses:** Communications, travel, miscellaneous fees

Operating expenses are expected to be at or very near the same amount as last year.

**Supplies/Equipment:** Office equipment, furnishing supplies

Expenditures for supplies and equipment are expected to be $28,100 less than FY94. The FY94 expenditures were increased above normal due to a decision to use available funds to make extra payments on the five year lease purchase contract for the modular furniture purchased in FY 1992. If sufficient money is available during FY95 additional early payments on the remaining balance due on the lease will be made.

STATE BOARD OF INVESTMENT
FISCAL YEARS 1995 BUDGET PLAN
GENERAL FUND SUMMARY

| DESCRIPTION | FY1992 ACTUAL | FY1993 ACTUAL | FY1994 PROJECTED | FY1995 BUDGET |
|---|---|---|---|---|
| PERSONAL SERVICES | | | | |
| CLASSIFIED EMPLOYEES | $ 260,837 | $ 314,534 | $ 327,381 | $ 342,295 |
| UNCLASSIFIED EMPLOYEES | 1,144,717 | 1,109,968 | 1,102,794 | 1,157,950 |
| PART-TIME EMPLOYEES | 0 | 0 | 0 | 0 |
| SEVERENCE PAY | 26,422 | 0 | 5,165 | 0 |
| MISCELLANEOUS PAYROLL | 3,814 | 6,077 | 4,800 | 5,055 |
| TOTAL PERSONAL SERVICES | $ 1,435,790 | $ 1,430,579 | $ 1,440,140 | $ 1,505,300 |
| EXPENSES & CONTRACTUAL SERVICES | | | | |
| RENTS & LEASES | 89,687 | 79,197 | 81,950 | 85,250 |
| REPAIRS/ALTERATIONS/MAINTENANCE | 6,872 | 9,124 | 9,250 | 10,000 |
| BONDS AND INSURANCE | 0 | 117 | 960 | 1,000 |
| PRINTING & BINDING | 14,802 | 15,547 | 13,650 | 18,000 |
| PROFESSIONAL/TECHNICAL SERVICES | 14,399 | 8,439 | 48,000 | 48,000 |
| DATA PROCESSING & SYSTEM SERVICES | 162,000 | 162,000 | 202,500 | 202,500 |
| PURCHASED SERVICES | 31,188 | 38,063 | 26,900 | 32,000 |
| TOTAL EXPENSES/CONTRACTUAL SERVICES | $ 318,948 | $ 312,487 | $ 383,210 | $ 396,750 |
| MISCELLANEOUS OPERATING EXPENSES | | | | |
| COMMUNICATIONS | 20,835 | 25,972 | 27,000 | 27,000 |
| TRAVEL, IN-STATE | 650 | 436 | 1,000 | 2,000 |
| TRAVEL, OUT-STATE | 38,678 | 36,593 | 40,000 | 40,000 |
| FEES & OTHER FIXED CHARGES | 7,134 | 5,589 | 9,000 | 8,000 |
| TOTAL MISCELLANEOUS OPERATING EXPENSES | $ 67,297 | $ 68,590 | $ 77,000 | $ 77,000 |
| SUPPLIES/MATERIALS/PARTS | 46,211 | 59,195 | 30,000 | 30,000 |
| CAPITAL EQUIPMENT | 17,078 | 96,189 | 62,600 | 34,500 |
| TOTAL GENERAL FUND | $ 1,885,324 | $ 1,967,040 | $ 1,992,950 | $ 2,043,550 |
| PERCENT INCREASE OVER PRIOR YEAR | | 4.3% | 1.3% | 2.5% |

**ATTACHMENT C**

## CONTINUING FIDUCIARY EDUCATION PLAN

## REQUIRED BY MS 356A.13

The State Board of Investment (SBI) undertakes the following activities related to fiduciary education. Taken as a group, these activities shall constitute the plan for continuing fiduciary education required by Minnesota Statutes 356A.13 (copy attached). In addition, pursuant to statutory requirements of qualification, the SBI executive director and many members of the Board's Investment Advisory Council (IAC) can be reasonably considered to be experts with respect to their duties as fiduciaries.

### 1. Briefing for New Board/IAC Members

Shortly after election to the Board or appointment to the IAC, each new member is briefed on SBI operations and policies. As part of the briefing, SBI's legal counsel will review the member's fiduciary obligations and responsibilities as specified in Minnesota Statutes Chapters 11A and 356A.

### 2. Development and Review of Investment Policies

The SBI adopts comprehensive investment policies for each fund under its control. The policies cover investment objectives, asset allocation, management structure and performance evaluation. Policy papers or reports on these topics are developed and written by SBI staff in conjunction with the IAC and consultants. Relevant research and analyses from the academic and professional investment fields are used to formulate these policy guidelines.

After they are formally adopted by the Board, these written policies guide the management of all assets under the SBI's control. The SBI intends to review its stated investment policies periodically. This review may occur within the framework of the SBI's regular quarterly meetings or may take place at special meetings or seminars specifically designated for this purpose.

### 3. Input from Board's Consultants

The SBI retains outside investment consultants to advise the Board members on a wide variety of investment management issues. As part of their contracts with the SBI, the consultants offer to meet with the Board members or their designees to discuss investment-related issues. These individual consultations occur throughout the year. In addition, the general consultant is available at each meeting of the Board and IAC. These meetings are supplemented by quarterly reports on investment performance prepared by the general consultant.

### 4. Manager "Round Tables"

The SBI intends to convene small groups of its external money managers to discuss issues related to investment management and the financial markets. These "round table" discussions will be held periodically throughout the year and will be open to Board members and their designees, IAC members and other interested parties. It is anticipated that 2-3 round tables will be held each year.

### 5. Travel Allocation

The SBI allocates $2,000 annually to each Board member (or their designee) for costs associated with attendance at investment-related seminars and conferences. This allocation is used at the discretion of each Board member.

Date: April, 1994

**1992 Minnesota Statutes**

356A.13. CONTINUING FIDUCIARY EDUCATION.

Subdivision 1. **Obligation of fiduciaries**. A fiduciary of a covered pension plan shall make reasonable effort to obtain knowledge and skills sufficient to enable the fiduciary to perform fiduciary activities adequately. At a minimum, a fiduciary of a covered pension plan shall comply with the program established in accordance with subdivision 2.

Subd. 2. **Continuing fiduciary education program**. The governing boards covered pension plans shall each develop and periodically revise a program for the continuing education of any of their board members and any of their chief administrative officers who are not reasonably considered to be experts with respect to their activities as fiduciaries. The program must be designed to provide those persons with knowledge and skills sufficient to enable them to perform their fiduciary activities adequately.

# ATTACHMENT D

*Preliminary*
**FY96-97 Biennial Budget Request**
**Overview**

The FY96-97 budget request is based on the SBI's FY95 Budget Plan and previous Department of Finance budgetary guidelines. Except for the contingency described below, staff anticipate a "same base level" request at this time.

Participation by local relief associations in the Supplemental Investment Fund (SIF) has grown dramatically in recent years. Participation is likely to increase even more rapidly in the future due to a number of factors, including increased interest by the Office of the State Auditor and the Legislature. Three years ago, fewer than 20 plans used the Fund. At the present time, more than 80 associations do so. This is only a small portion of the more than 800 funds who could choose to direct their investments through the SIF. As participation grows, additional resources are necessary to process a much higher volume of monthly contributions/withdrawals and provide regular statements to all participants. The amount shown below would fund one additional accounting position along with associated rent, supplies and equipment.

| | FY95 PROJECTED | FY96 REQUEST | FY97 REQUEST |
|---|---|---|---|
| Personnel | $1,505,300 | $1,505,300 | $1,505,300 |
| Contractual Services | 396,750 | 396,750 | 396,750 |
| Operating Expenses | 77,000 | 77,000 | 77,000 |
| Supplies and Equipment | 64,500 | 64,500 | 64,500 |
| **Total** | **$2,043,550** | **$2,043,550** | **$2,043,550** |
| **Relief association contingency** (not included in attachments) | | | |
| Personnel | | 35,000 | 35,000 |
| Other expenses | | 5,000 | 5,000 |
| | | **40,000** | **40,000** |

**Personnel Costs**
The FY96-97 figures on the attached report were prepared using the guidelines issued by the Department of Finance for FY 94-95. As a result, no allowance for salary increases is shown for FY96 or FY97. Salary increases are covered by collective bargaining agreements negotiated on a statewide basis. The SBI will not know what salary increases will be for the next biennium until the summer/fall of 1995. Funding for salary increases may or may not be available if increases are awarded. Any increases that must be absorbed within the current funding may necessitate layoffs.

**Other Expense Categories**
No allowance for inflationary cost increases has been made. As a result, unforeseen increases in data processing costs and other necessary contractual services could require adjustments in the amounts allocated to various expenditure categories.

STATE BOARD OF INVESTMENT
FISCAL YEARS 1996 - 1997 BIENNIAL BUDGET REQUEST
GENERAL FUND SUMMARY

| DESCRIPTION | FY1992 ACTUAL | FY1993 ACTUAL | FY1994 PROJECTED | FY1995 BUDGET | FY1996 BASE LEVEL | FY1997 BASE LEVEL |
|---|---|---|---|---|---|---|
| PERSONAL SERVICES | | | | | | |
| CLASSIFIED EMPLOYEES | $ 260,837 | $ 314,534 | $ 327,381 | $ 342,295 | $ 342,295 | $ 342,295 |
| UNCLASSIFIED EMPLOYEES | 1,144,717 | 1,109,968 | 1,102,794 | 1,157,950 | 1,157,950 | 1,157,950 |
| PART-TIME EMPLOYEES | 0 | 0 | 0 | 0 | 0 | 0 |
| SEVERENCE PAY | 26,422 | 0 | 5,165 | 0 | 0 | 0 |
| MISCELLANEOUS PAYROLL | 3,814 | 6,077 | 4,800 | 5,055 | 5,055 | 5,055 |
| TOTAL PERSONAL SERVICES | $ 1,435,790 | $ 1,430,579 | $ 1,440,140 | $ 1,505,300 | $ 1,505,300 | $ 1,505,300 |
| EXPENSES & CONTRACTUAL SERVICES | | | | | | |
| RENTS & LEASES | 89,687 | 79,197 | 81,950 | 85,250 | 88,550 | 92,000 |
| REPAIRS/ALTERATIONS/MAINTENANCE | 6,872 | 9,124 | 9,250 | 10,000 | 10,000 | 10,000 |
| BONDS AND INSURANCE | 0 | 117 | 960 | 1,000 | 1,000 | 1,000 |
| PRINTING & BINDING | 14,802 | 15,547 | 13,650 | 18,000 | 18,000 | 18,000 |
| PROFESSIONAL/TECHNICAL SERVICES | 14,399 | 8,439 | 48,000 | 48,000 | 48,000 | 48,000 |
| DATA PROCESSING & SYSTEM SERVICES | 162,000 | 162,000 | 202,500 | 202,500 | 202,500 | 202,500 |
| PURCHASED SERVICES | 31,188 | 38,063 | 26,900 | 32,000 | 32,000 | 32,000 |
| TOTAL EXPENSES/CONTRACTUAL SERVICES | $ 318,948 | $ 312,487 | $ 383,210 | $ 396,750 | $ 400,050 | $ 403,500 |
| MISCELLANEOUS OPERATING EXPENSES | | | | | | |
| COMMUNICATIONS | 20,835 | 25,972 | 27,000 | 27,000 | 27,000 | 27,000 |
| TRAVEL, IN-STATE | 650 | 436 | 1,000 | 2,000 | 2,000 | 2,000 |
| TRAVEL, OUT-STATE | 38,678 | 36,593 | 40,000 | 40,000 | 40,000 | 40,000 |
| FEES & OTHER FIXED CHARGES | 7,134 | 5,589 | 9,000 | 8,000 | 8,000 | 8,000 |
| TOTAL MISCELLANEOUS OPERATING EXPENSES | $ 67,297 | $ 68,590 | $ 77,000 | $ 77,000 | $ 77,000 | $ 77,000 |
| SUPPLIES/MATERIALS/PARTS | 46,211 | 59,195 | 30,000 | 30,000 | 30,000 | 30,000 |
| CAPITAL EQUIPMENT | 17,078 | 96,189 | 62,600 | 34,500 | 31,200 | 27,750 |
| TOTAL GENERAL FUND | $ 1,885,324 | $ 1,967,040 | $ 1,992,950 | $ 2,043,550 | $ 2,043,550 | $ 2,043,550 |
| PERCENT INCREASE OVER PRIOR YEAR | | 4.3% | 1.3% | 2.5% | 0.0% | 0.0% |

## ATTACHMENT E

**Country Groupings Designated by**
**The International Investing Guidelines Task Force in December 1992**
**Based US State Department Country Reports for 1991**

| Group 1 | Group 2 | Group 3 |
|---|---|---|
| Australia | Argentina | China |
| Austria | Brazil | Indonesia |
| Belgium | Chile | Kuwait |
| Canada | Colombia | Nigeria |
| Czechoslovakia | Egypt | Pakistan |
| Denmark | India | South Africa |
| Finland | Israel | USSR/former Soviet Union |
| France | Jamaica | Yugoslavia |
| Germany | Republic of Korea | |
| Greece | Malaysia | |
| Hong Kong | Mexico | |
| Hungary | Philippines | |
| Italy | Taiwan | |
| Ireland | Thailand | |
| Japan | Trinidad & Tobago | |
| Luxembourg | Turkey | |
| Netherlands | | |
| New Zealand | | |
| Norway | | |
| Poland | | |
| Portugal | | |
| Singapore | | |
| Spain | | |
| Sweden | | |
| Switzerland | | |
| United Kingdom | | |
| Uruguay | | |

ATTACHMENT F

MINNESOTA
STATE
BOARD OF
INVESTMENT



*Suite 105, MEA Bldg.*
*55 Sherburne Avenue*
*St. Paul, MN 55155*
*(612)296-3328*
*FAX (612)296-9572*



DATE: May 19, 1994

TO: Members, SBI Administrative Committee

FROM: Howard Bicker

**SUBJECT: Deferred Compensation Plan Contract Negotiations**

At the State Board of Investment (SBI) meeting on March 2, 1994, Board members directed me to continue contract re-negotiation efforts with the Deferred Compensation Plan providers. The purpose of the negotiation was to prepare a final contract to meet or exceed the terms as outlined in the letters of intent. SBI members asked that a proposal be brought to the Board at its June 1994 meeting.

Based on the discussion at the March 1994 Board meeting, I have continued to negotiate potential new contract terms with the current insurance company vendors, Great-West Life & Annuity Insurance Company (GW) and Minnesota Mutual Life Insurance Company (MM). MSRS staff has continued to negotiate potential new contract terms with the current marketers, National Benefits and Ochs Services. By statute, the SBI must approve all contracts for the Plan (see MS 352.96, subdivision 3, attached).

This memo reiterates my objectives for the re-negotiation with the insurance companies, summarizes the proposed contract terms as they have been modified by negotiations since the March Board meeting, and compares the proposed contract terms with the existing contract terms.

**Objectives of the Re-negotiation with Insurance Companies**

- Portability ( i.e., allowing participants to move money from one vendor to another).
- Similar range of investment options across vendors.
- Marketers work for MSRS and are not tied to the insurance companies.
- Equal marketing compensation across vendors with rates set by the State (SBI and MSRS), not the insurance companies.
- Specific termination dates and conditions in contracts.

**Enhanced Contract Terms Since March 1994**

Since the March 1994 Board meeting, I have been successful in negotiating contract terms that exceed those in the letters of intent that were presented to the SBI at that time. The most significant improvements affect the level of portability and the quality of the exit options upon termination of the proposed contracts.

*Portability:*

- Great-West has now agreed to allow participants to transfer each year 40 percent from their GW variable options to MM or Supplemental Investment Fund options and to allow participants to transfer 100 percent of maturing certificate balances to any GW variable option.

- Minnesota Mutual has now agreed to provide a 6-month window period during which participants may transfer 100 percent of fixed account balances to any investment option offered by the plan.

*Exit options:*

- Both MM and GW have now agreed to allow individuals to continue to direct their investments under the same portability and expense provisions under the proposed contract in the event the contract expires or is terminated.

In addition to the above improvements, Minnesota Mutual has been successful in improving its list of mutual fund options by coming to agreement with two mutual fund organizations that had earlier rejected proposals to provide particular fund options.

I believe that these terms and conditions represent a significant improvement over the provisions of the existing contracts with the insurance companies for the State's Deferred Compensation Plan. Therefore, I recommend that the SBI approve the proposed contracts. A summary of the proposed terms and conditions compared to the existing contract terms and conditions is attached. Full copies of the proposed contracts will be forwarded as soon as they are finalized.

MSRS Board is expected to approve the proposed marketing contracts at the MSRS Board meeting on May 20, 1994. I have reviewed these contracts with legal counsel and conclude that these contracts also meet their stated objectives. Therefore, I recommend that the SBI approve the proposed contracts between MSRS and the marketing organizations.

Attachment

**DEFERRED COMPENSATION PLAN CONTRACTS**

**Comparison of Current and Proposed Terms**
**As of May 1994**

| OBJECTIVE | CURRENT TERMS | PROPOSED TERMS |
|---|---|---|
| **Portability** | None. | MM:<br>• 100% for variable options.<br>• 20% or $1000, whichever is greater, each year for fixed options.<br>• 100% out of fixed options for first 6 months of new contract.<br>GW:<br>• 40% or $1000, whichever is greater for variable options each year.<br>• 100% of GW certificates at maturity to GW variable options. |
| **Investment Options** | Differing mix across vendors. | Similar mix of options:<br>-1 fixed option<br>-7 variable options |
| | Generally, in-house vendor options. | Name-brand mutual funds available. |
| **Termination Dates** | None. | June 30, 1999 |
| **Termination for Cause** | Criteria unclear. | Criteria delineated. |

**Comparison (Con't)**

| OBJECTIVE | CURRENT TERMS | PROPOSED TERMS |
|---|---|---|
| **Exit Options** | Individual participants face severe penalties. | Three options available:<br>• lump sum withdrawal with market rate adjustment<br>• installment withdrawal over 5 years at reduced interest rate<br>• no new contributions accepted but participants retain same portability and transferability |
| **Marketing Relationships** | Marketers tied to insurance companies. | Marketers work for MSRS. |
| **Marketing Costs** | Unequal compensation rates paid for marketing. | Equal rates across vendors. |
| | Vendors set rates paid to marketers. | Rates set by State (SBI, MSRS). |
| | Commission-based compensation. | Asset-based compensation. |

# Tab G

# STATE BOARD OF INVESTMENT

## Manager Commentaries

**Period Ending March 31, 1994**

**Manager Commentary**
**Alliance Capital Management L.P.**

| Period Ending: | 3/31/94 | Returns | Qtr. | Year |
|---|---|---|---|---|
| Total Firm Assets Under Management | $121 billion | Actual | -4.5% | 1.9% |
| Total Firm Assets Managed in this Discipline | $ 8 billion | Benchmark | -2.6% | -0.1% |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

   During the first quarter we underperformed our benchmark primarily because of the decline in the portfolio's performance in February. During this time the Bell Atlantic/Tele Communications merger was called off which negatively impacted the entire media sector an area that is a significant overweight versus the benchmark. Over the past year this group has been a positive factor. The other area of underperformance is the financial sector. As evidence of a stronger economy emerged long-term interest rates rose and the entire interest sensitive sector of the market declined. Our emphasis in technology partially offset these as semiconductor and personal computer stocks showed relative outperformance.

   For the fiscal year ending 3/31/94, the most positive impact on performance versus the benchmark came from our overweight in Motorola and Intel. Our underweight in healthcare was also a positive as the group declined on concerns of national healthcare reform. However, our large position in United Healthcare was a very successful investment. Our underweight in the consumer staple area was a slight positive with our large position in Philip Morris being a negative, but our significant underweight in the food group offset this as all consumer branded companies had a difficult period. As I mentioned our overweight in the media sector was positive as Lin Broadcasting and Paramount benefited from corporate takeover activity. For the year, our overweight in financials was mixed as the positive performance of financial stocks such as Merrill Lynch and Fannie Mae were offset by lower prices for General Re and Sallie Mae.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   Our active bets today involve a growing commitment to the cyclical growth area, i.e., autos, retail and airlines (UAL). The backdrop is our belief of an improving economy and the beginning of a several year cycle of good corporate profits. We continue to overweight financials and believe that financial growth stocks (i.e., NOB, FNM, MER) are the cheapest part of the market. Our overweight in cable and cellular continues as the cash flow multiples of these companies are now at the lowest level in several years and we believe alliances will be formed when the regulatory climate stablizes.

## Alliance (Con't)

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

| | |
|---|---|
| Accounts Gained: | Bell Atlantic |
| | State of Colorado |
| Accounts Lost: | McKnight Foundation |

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

   None

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## Staff Comments

No additional comments.

**Manager Commentary**
**Brinson Partners, Inc.**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $35.0 billion | Actual | -3.4% | N/A |
| Total Firm Assets Managed in this Discipline | $ 5.0 billion | Benchmark | -3.3% | N/A |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

   The portfolio continues to be overweight in stocks with the common characteristic of being economically sensitive although recent portfolio changes have begun to reduce this exposure. While economically sensitive stocks contributed meaningfully to performance throughout 1993, their contribution to first quarter performance was modest. The portfolio is also overweight with respect to stocks that are more financially levered than the market. Consistent with the increase in interest rates, stocks that ranked high with respect to financial leverage contributed to portfolio total return during the first quarter of the year. Market price volatility, as measured by the annualized standard deviation of 24-month trailing prices for the S&P 500, declined throughout much of 1993 to near record low levels. This low volatility, which can be viewed as a proxy for risk, reflected the relatively stable fundamental environment enjoyed by the U.S. stock market with respect to interest rates, inflation and real economic growth. We believe that the market has impounded this stable environment into security prices, and is therefore vulnerable to a decline as volatility reverts to normal historical levels.

   Industry weightings detracted from portfolio performance during the first quarter of 1994. positive returns from a relative underweight in electric utilities were more than offset by negative contributions from our relative overweights in drug and tobacco stocks as well as an overweight in transportation, including railroads and airlines. Stock selection was modestly negative for the first quarter of the year.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   Our process remains focused on identifying those stocks that are most attractive in price/value terms through intensive individual company analysis. Although the portfolio remains overweighted in stocks that possess a high degree of economic sensitivity, individual stock valuations support a measured shift away from economically sensitive stocks and toward some of the stable non-drug consumer oriented stocks. The portfolio also remains overweighted in stocks that rank high with respect to financial leverage. This is consistent with our belief that long-term interest rates will rise and that a portfolio of debtors will perform better that creditors in that environment.

## Brinson (con't)

We remain overweighted in financial/interest sensitive stocks. These companies continue to benefit from strengthening of the overall economy and improvements in credit quality (primarily real estate and consumer related). We are underweighted in the traditionally defensive consumer sector including non-durables, retail/apparel and discretionary spending stocks, although recent additions to the portfolio have diminished this underweight. We are underweighted in utilities, including both electric utilities and the traditional telephones. We believe that deregulation of electric utilities and the advent of retail wheeling of power will accelerate competitive pressure from non-utility generators and increase the purchasing power of larger power users. Competition will also intensify in the telecommunications industry as regulatory protection diminishes for the traditional regional telephone companies. The portfolio remains overweighted in health care and drug stocks. Despite the potentially negative effects of proposed health care reforms, this position is supported by the demographics of an aging population and technological advances in previously underserved areas of health care. Finally, we are overweighted in some of the basic industries, including aluminum and paper stocks.

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

We are pleased to report that our employee ownership of the firm has increased from 62% to 76% this year due to our purchase of a portion of minority shareholders' equity holdings. We believe that employee participation in the economics of our firm characterizes our commitment to the highest quality investment management and client service. Client assignments changed as follows:

| | | |
|---|---|---|
| Gained: | 8 accounts | $758 million |
| Lost: | 2 accounts | 61 million |

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None of significance this quarter.

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## Staff Comments

No additional comments.

**Manager Commentary**
**Forstmann-Leff Associates Inc.**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $2,942 million | Actual | -3.0% | 5.7% |
| Total Firm Assets Managed in this Discipline | $1,203 million | Benchmark | -3.0% | 2.1% |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*
   Over the last quarter, we performed pretty much in line with the benchmark. An overweight in the consumer durables, particularly the autos, was unproductive, as this area was affected by the March market decline. Although we benefited by an underweight in the consumer non-durables, our specific holdings in this area underperformed the market's. However, stock picking in the consumer services and the medical and related areas was much better than the benchmark returns in these areas, as was the case within the cycle sensitive and interest sensitive groups. We managed to provide positive returns in these sectors which were down 7.25% and 3.48%, respectively, in the benchmark.

   For the year, we provided a return 3.6% higher than the benchmark, which was in turn 0.60% higher than the broad market. Our sector bets generally paid off, including an overweight in the technology area and underweights in the poorly performing consumer non-durables and utility names. Stock picking added considerable value in several areas, including the consumer durables (concentrated in the autos), which were up 19.58%, the consumer services which were up 26.17%, and the medical and related groups. The few medical companies in which we did maintain positions produced a return of 28.75%, versus a 2.99% return in the benchmark. Key positions which added value to the portfolio in the year included Ford and General Motors in the consumer durables, General Motors Corp. Class H and Texas Instruments in the technology group, Marriott International and Host Marriott in the consumer services, HEALTHSOUTH Rehabilitation in the medical and related sector and Price/Costco and McDonald's in the consumer non-durables.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   We have begun to ease equity exposure, making selective sales in the technology groups, the retailers and some of the higher P/E issues. We had already taken gains in most of the bank positions, as discussed in previous letters, and predict that they will not benefit from a flattening yield curve. Such an environment could hold opportunities for the insurance group, and we are exploring possible investments. However, it is in the energy area that we have focused portfolio purchases thus far this year, and expect that further increases may be warranted. Worldwide oil capacity utilization is high, with only two to three million barrels a day of excess capacity. With a recovering European economy and continuing expansion in less developed economies, demand is likely to increase by one million barrels a day per year. With three years of excess capacity at best, we doubt that $15 to $16 per barrel is sustainable, and believe that the decade long weakness in oil pricing may be coming to an end. Prices in real terms are at levels consistent with those experienced prior to the 1974 oil crisis. Though we have maintained an exposure in the downstream refining and marketing area, we have previously underweighted the upstream production group, and purchases have recently been made to reposition the portfolio for advances in this area.

## Forstmann (con't)

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   Accounts gained in this discipline: 1 at $10.1mm
   Accounts lost in this discipline: 0

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

   A new manager of information systems position was established at the firm, and Warren Rosen was brought in for this position.

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## Staff Comments

No additional comments.

**Manager Commentary**
**Franklin Portfolio Associates Trust**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $5.3 billion | Actual | -2.2% | 5.6% |
| Total Firm Assets Managed in this Discipline | $361 million | Benchmark | -3.3% | 3.5% |

1. ***Past Performance. Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?***

**Fourth Quarter Performance:**
Because of the general decline in equity markets in the first quarter of 1994, the account and benchmark experienced negative return. On a relative basis, however, we are pleased to report that the account performed significantly better than its benchmark, declining 2.2% compared to a negative 3.3% for the benchmark. The active return in the account came from stock selection bets, active factor bets and industry bets. Stock specific return is the active return contribution after removing the effect of factor and industry returns. The return from stock selection was approximately 40 basis points. factor and Industry contributions represent the combination of the bets made relative to the benchmark and the performance of these factors and industries during the period.

The positive factor bets were Earning-to-price and Book-to-price. These bets contributed approximately 79 basis points to performance. Negative industry bets in Foods, Paper, Telephones, Drugs and Textiles contributed positively to performance. The contribution from these bets was an estimated 91 basis points. A positive average bet in Pollution control contributed an additional 17 basis points. All bets are stated relative to the accounts' benchmark.

Industry bets that hurt performance included positive bets in Leisure, Banks, Insurance, Miscellaneous Finance, Air Transport and Utilities. These bets hurt performance by about 135 basis points. A negative bet on Services also hurt performance by approximately 9 basis points.

**Twelve Month Performance:**
Account performance over the past twelve months has been both positive and well ahead of the benchmark. The account return was 5.6% compared to 3.5% for the benchmark. Positive contributions to active returns were made from stock selection as well as factor and industry bets.

The factor bets that contributed to return were Earnings-price, earnings variability, variability in markets, and Book-to-price. The total contribution was estimated to have been 175 basis points. Positive bets in Electronics, Business Machines and negative bets in Paper, Drugs, and Pollution Control contributed an estimated 132 basis points of active return.

A negative bet on Leverage resulted in a -28 basis points impact on performance. Negative industry bets in Telephones, Produced Goods, Services, Publishing, Chemicals and positive industry bets on Banks, and Air Transport contributed an estimated -207 basis points impact on performance.

## Franklin (con't)

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   As of 3/31/94, the following active bets existed in the account relative to the benchmark:

   A. Factor bets (bets stated as a standard deviation from benchmark):

   | | |
   |---|---|
   | Success | 0.14% |
   | Earnings/Price | 0.37% |

   B. Industry bets (bets stated as percentage deviation from benchmark weight):

   | | | | |
   |---|---|---|---|
   | Banks | 3.78% | Telephones | -3.94% |
   | Consumer Durables | 2.54 | Producer Goods | -2.85 |
   | Food Stores | 2.47 | Paper | -2.06 |
   | Gas Utilities | 2.42 | | |

   C. Issue bets (bets stated as percentage deviation from benchmark weight):

   | | | | |
   |---|---|---|---|
   | Compaq Computer | 2.55% | General Motors Cl E | 2.53% |
   | Johnson & Johnson | 2.47 | Mobil Corp. | 2.44 |
   | Kroger Co. | 2.26 | Wendys Int'l | 2.16 |

   All active bets in the portfolio are based on two considerations. These are the rank of individual issues and the overall tracking error or risk of the total portfolio relative to the benchmark. The portfolio construction objective is to obtain as high a rank as possible consistent with the tracking objective. We seek to maintain a total tracking error of approximately 3% relative to the benchmark with approximately 70% to 80% of the tracking error resulting from stock bets. As a result of the stock selection bets, the portfolio will acquire the factor and industry bets as described above.

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   There have been no significant ownership or personnel changes at our firm since the last quarter.

   | **Accounts gained:** | | **Accounts lost:** | |
   |---|---|---|---|
   | Corporate Pension Fund: | $300 million | Foundation: | $70 million |
   | | | Savings Plan: | $20 million |

   Both account losses were for reasons other than performance.

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

   None

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## Staff Comments

No additional comments.

**Manager Commentary**
**GeoCapital Corporation**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $1.7 billion | Actual | -2.9% | 13.0% |
| Total Firm Assets Managed in this Discipline | $1.7 billion | Benchmark | -4.2% | 15.1% |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

   Performance in the last quarter outperformed the benchmark portfolio. Our continuing active bets in consumer non-durables and technology added value in the three months ending March 31st. Stocks that helped our performance in these sectors included Compuware, Adobe, BMC Software, and NFO Research. These companies performed well because of higher than expected earnings trends. In addition, Foundation health, Maxicare and Medical Care America also did well as health care reform became more realistic. On the negative side, Scholastic, Star Sight, Structural Dynamics, Parametric Technology and Pacific Physicians performed poorly in the quarter. This was due to expectations for growth in earnings diminishing. Financial stocks also added value in the last period. Our small position in consumer durables, energy and basic materials hurt the relative performance. Centex, Viacom and Legg Mason performed poorly as interest rates moved up. John Wiley and LaQuinta moved ahead due to recognition of corporate value.

   We continue restructuring the universe of our benchmark portfolio and we will fine tune this index over time.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   Our active bets in the 1st quarter continue the same trend as stated in September. In that regard, we would continue to state the following rationale:

   A. The improving yield curve and asset growth (with improved profitability) combined with industry consolidation in the financial areas.

   B. The unfolding improvement in business and stock market valuations of small growth issues in both technology and medical service as overall macro strength remains weak and industry selection becomes paramount. With the new proposed health care legislation finally promulgated, medical service companies should have significant potential to grow independently of the overall economy.

## GeoCapital (con't)

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   No changes.

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

   N/A

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## Staff Comments

No additional comments.

**Manager Commentary**
**Investment Advisers, Inc.**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $13 Billion | Actual | -2.0% | N/A |
| Total Firm Assets Managed in this Discipline | $780 Million | Benchmark | -2.9% | N/A |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

   The quarter ending March 31, 1994, was a difficult period for investors as interest rates moved higher and markets (both stocks and bonds) moved lower. We anticipated the weakness and spread our risks (70 issues) and lowered beta by cashing in some of our winners to underweighted positions. Also, we avoided sectors that were underperforming; i.e., utilities, energy, etc. We continue to use a bottom up approach and more values are showing up, especially in the financial area. Generally, sector bets and portfolio strategy has performed well for the last 90 days and 12 months.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   Going forward we intend to use our cash (13%) to take advantage of some better pricing in the market place with some emphasis on S&L, banking, selected consumer durables, retailing and specialty retailing, and companies in the mid-cap area with good earnings momentum; i.e., Johnson Controls (capital goods), Andrew, Tellabs (telecommunications), Harley Davidson (consumer durables), etc. The overall environment remains hostile and liquidity concerns are high.

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   During the first quarter of 1994, there were not any ownership changes. During the first quarter of 1994, R.J. New and John Twele (equity portfolio managers) and Murray McLachlan (marketing & client servicing) joined the firm. Valerie Sill (equity analyst) left the firm. We have not lost or gained any accounts in this discipline this past quarter.

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

   N/A

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**Staff Comments**

No additional comments

**Manager Commentary**
**IDS Advisory Group, Inc.**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $18.4 billion | Actual | -2.6% | 4.4% |
| Total Firm Assets Managed in this Discipline | $ 4.9 billion | Benchmark | -3.0% | 3.5% |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

As indicated above, IDS Advisory outperformed the Normal Portfolio by 40 basis points during the quarter and 90 basis points during the latest 12 months.

Our sector weights have evolved as follows.

| | **3/31/93** | **3/31/94** | **S&P 500 3/31/94** |
|---|---|---|---|
| Technology | 7.2 | 12.1 | 11.4 |
| Consumer Stable | 4.5 | 4.4 | 19.4 |
| Consumer Cyclical | 24.8 | 25.6 | 20.5 |
| Utilities (non Electric) | 1.9 | 3.4 | 9.6 |
| Financial Services | 11.6 | 17.2 | 12.4 |
| Energy | 7.8 | 5.2 | 5.8 |
| Industrial Basic | 13.6 | 13.6 | 4.2 |
| Industrial Growth | 9.1 | 12.6 | 7.9 |
| Industrial Cyclical | 9.1 | 12.6 | 7.9 |
| Equity Cash | 12.9 | 2.3 | 5.0 |
| | 100.0 | 100.0 | |

As you will note, our weighting in technology has increased significantly over the latest 12 months and is greater than the S&P 500. We are significantly overweighted in the consumer cyclical area as well as in the financial service, industrial basic, and industrial cyclical sectors. During both the latest quarter and the year, most of our sector and industry weighting decisions contributed to our superior performance. In particular, our technology, consumer cyclical, industrial basic, and industrial intermediate cyclical sector decisions proved beneficial. However, the financial sector significantly underperformed the market in the second half of 1993 and provided a mixed rate of return in the first quarter of 1994. The portfolio was significantly underweighted in the utility and consumer stable sectors as well as among the energy stocks. Both energy and consumer stables stocks underperformed the market over the last 12 months while utilities turned in a mixed performance. During much of 1993, utilities generated superior rates of return. However, in the first quarter utilities proved to be absolutely dismal securities. On the whole, our sector decisions proved beneficial and our stock selection also appears to have added to performance.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

We are sanguine about the economy. We anticipate real GDP growth of approximately 3 1/2 percent, inflation of approximately 3 percent, and earnings growth of 15 percent. We are forecasting an increase in short-term interest rates to 4 1/2 to 5 percent by the end of this year. Thirty-year Treasury rates are expected to show little change from current levels. We believe this economic forecast provides a positive background for common stocks.

IDS Advisory feels that the market can generate a total rate of return of at least 10 percent this year. We are encouraged by both market valuation and the high level of pessimism among professional investors. The market is currently selling at 14x our estimate of S&P 500 operating earnings of $31. Next year's PE is less than 13x operating earnings. In our opinion, this represents attractive valuation. Regarding investor attitudes, a high level of caution clearly exists. The put call ratio is at an all-time high and shorting is also at record levels. In addition, most Wall Street gurus have turned bearish and polls of investor sentiment show a very high level of caution. We continue to believe in the old adage that bull markets climb a wall of worry.

We feel that the market will be driven by earnings momentum. While we recognize that a number of cyclical sectors are undergoing significant corrections this month, we continue to believe that many of these sectors, industries and stocks represent excellent value. In particular, we anticipate increasing technology weightings in coming months if this sector remains under pressure. While both energy and consumer stables may outperform during periods of market volatility, we do not believe that these sectors represent new market leadership. Given our reasonable optimistic view of the equity market, we do not intend to increase cash positions.

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

There have been no ownership or personnel changes at IDS Advisory Group in the last quarter.

**IDS ADVISORY GROUP**

| | Gains | | Losses | |
|---|---|---|---|---|
| **Product** | **# of Accounts** | **Assets ($MM)** | **# of Accounts** | **Assets ($MM)** |
| Large Cap Equities | 0 | 0 | 1 | 2.9 |
| Fixed Income | 2 | 103.1 | 0 | 0 |
| Balanced | 4 | 24.3 | 0 | 0 |
| International | 0 | 0 | 2 | 317.6 |

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None at this time.

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**Staff Comments**

No additional comments.

## Manager Commentary
## Independence Investment Associates

| Period Ending: | 3/31/94 | Returns | Qtr. | Year |
|---|---|---|---|---|
| Total Firm Assets Under Management | $14 billion | Actual | -3.9% | 2.0% |
| Total Firm Assets Managed in this Discipline | $ 7 billion | Benchmark | -3.7% | 0.8% |

1. ***Past Performance.** Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

   Your portfolio performed well during 1993, outperforming the benchmark by 2.1%. We construct your portfolio we make certain that the majority of non-market risk we are taking is in the area of specific stock selection, as this is the area where we have been consistently able to add skill over time. Although our Cybercode valuation model's skill will vary from quarter to quarter, it worked well over the full year of 1993, with 100% of its forecasting skill being attributable to individual stock selection. This is above Cybercode's historical average of 75%. For the first two months of 1994, the Cybercode model had slightly negative skill in differentiating between the attractive and unattractive securities but bounced back in March. Intrinsic value between the attractive and unattractive securities but bounced back in March. Intrinsic value models such as our dividend discount model performed better than the earnings momentum components. While the majority of the combined models' return came from specific stock selection, as is in keeping with our approach, it was largely concentrated in March, causing some underperformance in your portfolio for the three months combined.

   Major purchases during the quarter included Aetna, Bellsouth and Abbott while American International Group, Sara Lee and Heinz were eliminated. The best performing stocks in your portfolio were Texas Instruments, Avon and Eaton. The worst performing stocks were Amgen, Pfizer and Stratus.

2. ***Future Strategy.** What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   We continue to manage your portfolio in the NIXDEX diversified core strategy. It is well diversified holding 123 stocks with market like bets. The number of securities held has slightly increased from last quarter as a result of enhancement made to the BARRA US. Equity Risk Model, allowing us to further concentrate our active bets on stock selection. Our philosophy of buying stocks that are cheap with improving fundamentals continues to pervade throughout your portfolio.

   As always, your portfolio does not have any style bias and in fact shows characteristics of both value and growth as measured by a low P/E and high earnings growth. The P/E of your portfolio is 12.4x versus the S&P 500 P/E of 16.2x. The long term expected earnings growth of your portfolio is 9.1% compared to the S&P 500 long term growth of 7.0%. The dividend yield of 2.98% of your portfolio is in line with that of the S&P 500.

## Independence (con't)

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   With pleasure, we announce the election of Samuel A. Otis, CFA as a Principal of Independence Investment Associates. Sam's contributions in portfolio management and asset allocation are valuable and he is a contributor to all aspects of the firm. Sam has been with Independence since its inception, currently manages 19 portfolios and is active in the company's asset allocation decisions.

   Mary Jane Bush, Senior Vice President and Head Trader, has recently been elected to the Board of Governors of the Boston Stock Exchange. Mary Jane is the first woman to be elected to the board and will serve a two year term. Her election is testament to her professionalism as well as to the respect she has within the trading community.

   During the first quarter of 1994, we had a net gain of 12 accounts bringing our total account to 179, with 128 clients. Of the new accounts, 8 were in the NIXDEX diversified core strategy. During this period, no accounts were lost in this strategy.

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

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## Staff Comments

No additional comments.

**Manager Commentary**
**Jundt Associates, Inc.**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $3,182 billion | Actual | -1.0% | N/A |
| Total Firm Assets Managed in this Discipline | $1,476 billion | Benchmark | -2.8% | N/A |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

The value added during the period under review was +2.0. In macro terms the portfolio benefited from excellent absolute sector allocation (+1.8) and stock selection (+1.6) and trading (+0.4). Relative sector times selection yielded was negative (-1.3).

The two economic sectors that added the most value to your portfolio were consumer non-durables (retailers) and technology which combined were close to 80% of the portfolio. To be more specific, the retailing area did well in the time reviewed and especially in some of the names we owned. Our biggest winner was hometown favorite Best Buy which was up 37% in the first quarter of 94 alone. Other winners included: Lowes and Home Depot in the "home do it yourself" market; Office Depot in the office supply market and Walmart in the own the whole world market!

As exclusively growth stock managers, technology is always a very important part of our portfolio. We saw positive returns in the telecommunications and software portions of technology. Our biggest winner in the telecommunications area was Motorola who is involved in almost every facet of communications technology around the world. In the software area the two dominant themes were networking and distributed data base software. In the networking area Cisco Systems and Wellfleet continued to do well for us. In the database software market we saw excellent results in Oracle, Sybase, and Informix. Other software and hardware companies that performed well were: Microsoft; EMC; Intel; and BMC software.

One final note, another local company performed extremely well for us in the health care sector, that being United healthcare, one of the nations premier HMO's.

No other economic sector caused any undue negative pressure in the quarter. Cash levels were approximately the same as the benchmark.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

The current portfolio remains very much the same as of the end of the March quarter. Cash levels remained at about 8%. We continue to invest on a bottom up approach, and note that continued strong investment themes include wireless communications; computer software; multimedia and interactive TV; and specialty retailing. Relative to the benchmark we continue to be overweighted in technology, slightly underweighted in consumer non-durables, and well underweighted in transportation, basic materials, and financial stocks.

## Jundt (con't)

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   None to report.

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

   The portfolio we have created for the State of Minnesota is showing strong long term growth in excess of 20-25% in sales and even higher earnings per share. We feel that ultimately these rates of growth will be reflected in the market place.

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## Staff Comments

No additional comments.

**Manager Commentary**
**Lincoln Capital Management Company**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $27.0 billion | Actual | -3.1% | N/A |
| Total Firm Assets Managed in this Discipline | $ 8.3 billion | Benchmark | -2.9% | N/A |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

   The portfolio return underperformed the Benchmark by 15 basis points during the first quarter of 1994. Among the large holdings that performed well were Gillette, Intel, Microsoft, Freddie Mac, Wal-Mart and GM-E. In the first four cases, business progressed at a better than anticipated rate and EPS estimates were rising. GM-E (EDS) captured two huge contracts in the computer out-sourcing industry. The rebound in Wal-Mart reflects solid sales and a bounce back from a somewhat depressed year end price. Toys "R" Us, PepsiCo, Pfizer and Automatic Data lagged mostly because of earnings shortfalls. It was a generally eclectic market, more stockpickers' than sector-driven.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   The portfolio remains a bit "short" in technology/communication (valuations a bit too high, in our opinion) and health care (uncertain fundamentals), "long" in consumer and financials. In these latter two sectors, the portfolio companies are reporting solid EPS growth while their relative valuations are at low levels historically.

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   Bill Goldsborough, who is taking early retirement, has just sold his stock to about six other professionals. The search for Bill's successor is in its final stages; he will continue on here until his successor arrives.

   Lincoln has one new equity relationship, lost none.

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

   None.

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## Staff Comments

In the wake of Bill Goldsborough's retirement, Lincoln Capital has decided to hire two people. They are Gretchen Lash, from American Capital in Houston and Alan Sebulsky, from Morgan Stanley in New York City.

Gretchen has been with American Capital Asset Management for eight years. She was initially ACAM's retail analyst and recently Vice President and a mutual fund portfolio manager. Prior to 1986 she was for nine years in the retail industry, mostly as a buyer for several department stores including Macy's and May. She received her undergraduate degree from Cornell and her MBA from Rice.

Alan, who recently attained the position of Managing Director at Morgan Stanley, has been on that firm's health care research team for six years during which he became well known to Lincoln. Alan joined Morgan Stanley from T. Rowe Price where he had been an analyst and mutual fund manager for six years. He received both his undergraduate and MBA degrees from the University of Wisconsin.

Lincoln uses a team approach involving all equity analysts. Gretchen Lash and Alan Sebulsky will be part of that investment team at Lincoln. Staff expects the changes within the investment team to have an impact on SBI's portfolio.

**Manager Commentary**
**Lynch & Mayer, Inc.**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $5,113 million | Actual | -2.2% | -0.6% |
| Total Firm Assets Managed in this Discipline | $4,537 million | Benchmark | -2.3% | 8.1% |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

Significant over and underweighting sector results for the quarter were:

| **Sector** | **Portfolio Weighting** | **Portfolio Results** | **Benchmark Weighting** | **Benchmark Results** |
|---|---|---|---|---|
| Technology | 30.8% | 1.5% | 24.0% | 5.4% |
| Consumer Non-Durables | 21.0% | -8.4% | 32.6% | -6.8% |
| Capital Goods | 13.4% | 10.2% | 4.0% | 4.5% |
| Total | | -2.1% | | -2.3% |

According to the Economic Sector Performance Attribution Analysis prepared by Richards & Tierney, sector allocation relative to the benchmark produced a positive 200 basis point return. However, stock selection relative to the benchmark produced a negative 135 basis point return for the quarter.

The capital goods sector produced the greatest value added for the quarter. The value added was two fold: proper sector overweighting relative to the benchmark and proper stock selection relative to the benchmark. Specifically, we initiated or increased positions in Caterpillar and Deere as these companies will benefit from increased capital expenditures here and abroad. Although we were properly overweighted in the technology sector relative to the benchmark, stock selection relative to the benchmark resulted in negative value added. Most of the underperformance is attributable to DSC Communications (2.4% position) and MCI Communications (2.3% position) declining during the quarter by 18% and 17%, respectively. Both of these companies are in the telecommunications industry and the industry is under severe pricing pressure.

For the twelve months ended March 31, 1994, the portfolio underperformed the benchmark by 847 basis points. Although the portfolio was properly over and underweighted in the appropriate sectors, stock selection relative to the benchmark did not add value. Once again the portfolio was properly overweighted in the technology sector relative to the benchmark, however many smaller capitalization technology issues, that are heavily weighted in the benchmark, performed very well. Additionally, trading and other costs, as measured by Richards & Tierney, reduced investment performance by approximately 400 basis points.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

As mentioned above, we have increased our position in capital goods companies as these companies should benefit from increased capital expenditures. Rising corporate profits, still low <u>real</u> interest rates, and greater worldwide demand for infrastructure projects suggest that capital spending will continue. Most of the companies in this sector have been through a decade of corporate restructuring and, with some top line growth, are poised to demonstrate accelerated earnings growth. The top ten holdings as of March 31, 1994 relative to the benchmark are:

| Holding | Rational for Investment | Portfolio Weight | Benchmark Weight |
|---|---|---|---|
| Wells Fargo | Acceleration of Growth | 4.3% | 0.1% |
| Deere | Acceleration of Growth | 4.0 | 0.9 |
| Hewlett-Packard | Acceleration of Growth | 4.0 | 1.1 |
| Motorola | Improved Industry Environment | 3.9 | 2.0 |
| Proctor & Gamble | Restructuring/Acceleration of Growth | 3.9 | 0.3 |
| General Motors | Restructuring | 3.8 | 2.0 |
| Gillette | Acceleration of Growth | 3.3 | 0.5 |
| Columbia Healthcare | Restructuring | 3.1 | 0.6 |
| United Technologies | Turnaround/Restructuring | 3.1 | 0.1 |
| Caterpillar | Improved Industry Environment | 3.0 | 1.3 |

Our investment philosophy hinges on the premise that earnings growth significantly above historical trend or consensus expectation invariably is preceded by a critical positive fundamental change. We search intensively for early indications of such change and group purchase candidates into four categories by source of earnings increase. The categories are: acceleration of growth; improved industry environment; corporate restructuring; and "turnaround" situations

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

No significant personnel or ownership changes occurred.

Accounts gained (tax-exempt): Community Medical, Lamson & Sessions Co., Lutheran Charities Foundation, National Geographic Society, Northern Indiana Public Service Co.

Accounts lost (tax-exempt): None

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

During the quarter, we met with Mike Menssen of the State Board of Investment and Tommy Huie of Richards & Tierney to discuss the security weighting scheme used in the preparation of our customized benchmark. We are evaluating, with the help of Richards & Tierney, whether the scheme should be modified. We plan to communicate our findings to Mike Menssen before we implement a revised weighting scheme.

## Staff Comments

As with any benchmark, staff will request or consider refinements as more data is collected and a better understanding of the benchmark characteristics becomes available. Staff will evaluate any proposals made by Lynch & Mayer very carefully and incorporate changes only if we can be assured that the modifications more accurately reflect the firm's investment style.

**Manager Commentary**
**Oppenheimer Capital**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $27.7 Billion | Actual | -2.8% | N/A |
| Total Firm Assets Managed in this Discipline | $13.5 Billion | Benchmark | -2.7% | N/A |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

QUARTER ENDED MARCH 31, 1994

The key factors contributing to performance during the quarter were security selection within the following economic sectors: basic industry, conglomerates and banks.

Significant weighting variations in the basic industry, consumer cyclical, energy and utilities sectors were rewarded. However, overweighting in the financial services and insurance industries negatively impacted performance. The top contributing stocks for the quarter are as follows:

| | | | |
|---|---|---|---|
| Hercules | 25.2% | Pfizer | 16.7% |
| Temple Inland | 24.1 | Freeport McMoRan | 14.9 |
| Philip Morris | 22.7 | Monsanto | 13.0 |
| Tyco Lab | 19.6 | GE | 10.1 |

NINE MONTHS ENDED MARCH 31, 1994 (Inception 7/1/93)

The key factors contributing to performance were security selection within basic industry, capital goods, conglomerates, financial services and insurance sectors. Higher exposure to basic industry, capital goods, and consumer cyclicals and lower exposure to energy and utilities were rewarded. The top contributors within each economic sector that significantly affected performance are as follows:

| | |
|---|---|
| Basic industry: | Hercules, Monsanto |
| Capital goods: | Tyco Labs, Martin Marietta, GE |
| Conglomerates: | Allied Signal |
| Financial Services: | Salomon |
| Insurance: | Progressive |

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets*

We continue to maintain significant positions in financial stocks. We do not own these stocks because of a particular interest rate forecast. They represent well positioned businesses with motivated managements and their valuations are compelling. The same is also true for our consumer non-durable holdings. We focus on high return companies that generate excess capital. Management's ability to allocate capital for the benefit of the shareholder creates value over time. Eventually that value will be recognized by the market.

## Oppenheimer (con't)

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

**PERSONNEL CHANGES**

Lisa Aadal joined Oppenheimer Capital as a Vice President and Client Service Executive. Since 1989 she has worked as Director of Marketing for the Journals Division of Institutional Investor, the Publishers of The Journal of Portfolio management, The Journal of Fixed Income and The Journal of Investing. Prior to that, she spent several years at AIG Global Investors marketing, as well as servicing, corporate and public funds in the United States and financial institutions in the Far East. Lisa holds an BA from Sarah Lawrence College.

Noreen Clark joined Oppenheimer Capital as a Vice President and Client Service Executive. Prior to joining Oppenheimer Capital she was with RJR Nabisco for five years where she was involved in three areas of corporate treasury: Investor Relations, Risk Management and Pension Investments. For eight years prior, she worked for American Standard in the Pension Investments Division. Ms. Clarke has a BA in Economics from Stonehill College, and MBA in Finance from the Suffolk School of Management and is a Chartered Financial Analyst.

**ACCOUNTS GAINED/LOST**

| | |
|---|---|
| Gained: | 3 accounts with $45.1 million in assets |
| Lost: | None |

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

The solid five year track record of our small cap mutual fund and interest from the marketplace has recently prompted us to expand our small cap product offering to included separate account management.

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## Staff Comments

No additional comments.

**Manager Commentary**
**Waddell & Reed**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $2.8 billion | Actual | 1.7% | 13.6% |
| Total Firm Assets Managed in this Discipline | $4.8 million | Benchmark | -1.4% | 11.8% |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

   Strong demand for semiconductors and computers helped drive up stock prices of Micron Technology and Compaq Computer while a surge in interest rates hurt brokerage industry psychology and the perception of future growth of these companies. We believe they remain excellent values going forward.

   Our relatively heavy investments in technology companies such as Micron Technology and Compaq Computer as well as in Mattel helped our quarterly and past year performance results. Moreover, for the trailing twelve months, we benefited from our sizable investments in Southwest Airlines, Blockbuster Entertainment, and CBS.

   We recently added to our semiconductor and computer software holdings such as National Semiconductor and Microsoft. In addition, we built positions in banking and healthcare through Wells Fargo, Signet Banking, United Healthcare, and U.S. Healthcare. In healthcare and technology, we see selected unit volume gains continuing at a robust pace, leading to strong earnings gains.

   We reduced our position in McDonald's due to slower projected relative earnings growth in the consumer sector, and took profits in the broadcasters (CBS, Capital Cities/ABC) as the price reflected the companies improved prospects.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   The economy has picked up momentum recently, due to strong consumer spending. We expect a slowing trend in the aggregate growth rate because it is not being driven by proportionate gains in disposable personal income. Interest rates likely will stabilize or decline somewhat, later this year, helping bonds and interest sensitive stocks. Regarding stocks, we believe financial service companies (Merrill Lynch & Salomon) will perform well over the balance of the year as will technology companies with strong unit volume growth (Micron, Intel and Compaq). We also believe growth prospects for Blockbuster Entertainment and Mattel are still undervalued and look forward to good relative performance.

## Waddell (con't)

In the year ahead, we see the portfolio benefiting from a macro environment of moderate economic growth and continued low levels of inflation. Due to the fact that businesses have downsized, profits will rise satisfactorily, even though volume growth may be mediocre for the average company. We expect our companies to show superior earnings growth due to a combination of rising profit margins and above average volume growth. The period ahead may continue to prove quite volatile. However, we continue to feel that as long as profits expand in line with expectations and interest rates do not continue to rise to any significant degree, selected stocks will produce respectable gains.

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   The portfolio manager for our specialty gold/government fund retired. His responsibilities were absorbed by another investment professional. There were no accounts gained or lost in this discipline.

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

   None.

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## Staff Comments

No additional comments.

**Manager Commentary**
**Weiss Peck and Greer**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $13.2 billion | Actual | -4.3% | N/A |
| Total Firm Assets Managed in this Discipline | $ 1.6 billion | Benchmark | -3.4% | N/A |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

   There were three active bets on the quarter.

   **Consumer Non-Durables:** Underweight. This worked in the sense that the sector provided worse returns than the benchmark. Our stocks outperformed thus this was a positive contributor.

   **Capital Goods:** A continued overweighting was a positive contributor. Our stocks did less well than the benchmark although stock selection has improved.

   **Financial:** Our overweight commitment did not work in terms of either sector or stocks. A large percentage of our commitment was to insurance sector which was particularly disappointing.

   These later two sectors, Capital Goods & Financial, encompassed most of underperformance.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   Going forward the same relative sector bets remain. Within the consumer non-durable area we are reducing the commitment to healthcare.

   Within the capital goods area there will be some changes dictated by relative attractiveness as the result of analysts' input, reported earnings and changes in growth rates. For instance Novell, Storage Tech, Micron, Peoplesoft and BMC Software have all been reduced as their <u>relative</u> attractive ratings have fallen.

   We remain convinced on our insurance commitment.

## Weiss Peck (con't)

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   There were no significant ownership or personnel changes at Weiss, Peck & Greer. There were no accounts lost in the discipline. Over $5.0 million institutional commitments were added to the Growth Fund by the Local 25 S.E.I.U. and Participating Employer's Pension Trust.

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

   We completed our effort to raise CDA IV, a partnership fund in the private company buyout area. The total fund is approximately $180.0 million. We are now in the process of raising a fund for our Venture Capital area.

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## Staff Comments

No additional comments.

**Manager Commentary**
**BEA Associates**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $20.4 billion | Actual | -3.0% | N/A |
| Total Firm Assets Managed in this Discipline | $ 3.5 billion | Benchmark | -2.8% | N/A |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

   Unaudited performance for the period dated 1/1/94 to 3/31/94 was -3.84% versus a return of -2.80% for the Salomon BIG Index. Approximately 80 basis points of the underperformance can be attributed to futures and options related strategies that were structured to benefit from a decline in global volatility. Due to a series of events, with the most noteworthy being the Federal reserves decision to raise short-term rates, global volatility rose and put derivative trades in a loss position. The other 20 basis points of widening can be attributed to weakness in the International Bank perpetual floating rate note (FRN's) market in which we have a 6.5% position and a widening of BBB spreads where we have a modest over exposure.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   As BEA continues to be short volatility via hedged Futures and Options. As financial and political uncertainties abate, volatility should decline and these trades should add value. The bank FRN positions represent a long-term play on the United Kingdom and Scandinavian bank sector. We see margins and balance sheets continuing to improve. Coincident with volatility's rising, lesser credits have suffered (RJR, Time Warner, Arkla). The triple B sector should improve as the recent uncertainty abates.

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   No change in personnel or ownership. No new stand alone fixed income assignments.

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

   None.

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**Staff Comments**

No comments at this time.

**Manager Commentary**
**Investment Advisers, Inc.**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $13.5 billion | Actual | -3.5% | 3.2% |
| Total Firm Assets Managed in this Discipline | $ 4.5 billion | Benchmark | -2.8% | 2.5% |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

   The portfolio underperformed its benchmark for the quarter, but outperformed for the last year. Our overweighting in long duration assets reduced relative returns during the quarter by about 130 basis points. Our barbelled yield curve strategy and sector-issue selection strategy each added about 20 basis points of relative return.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   Duration was reduced to 5.8 years, but still exceeds the market benchmark by about one year. Long duration and short duration assets exceed their respective market weightings, giving the portfolio a more pronounced barbell yield curve strategy. Asset-backed issues are overweighted; the mortgage-backed sector is underweighted; and corporate bond exposure has been reduced to an underweighted position. During the second quarter we expect the yield curve to flatten further, with long rates dropping below 7%. Corporates and mortgages will modestly underperform comparable duration governments.

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   Larry Hill has assumed the responsibility of Chief Investment Officer of IAI. John Twele has joined IAI as a senior equity analyst/portfolio manager in large cap equities (effective April 3). No fixed income accounts were gained or lost in this discipline during the quarter.

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

   None

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**Staff Comments**

No comments at this time.

**Manager Commentary**
**Miller, Anderson & Sherrerd**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $29.7 billion | Actual | -2.9% | 4.2% |
| Total Firm Assets Managed in this Discipline | $18.1 billion | Benchmark | -2.8% | 2.5% |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

   The total return of your portfolio for the first quarter of 1994 was -2.47% versus -2.80% for the Salomon Broad Index and -2.87% for the Lehman Aggregate Index.

   The active bets within your portfolio in the last quarter included a significant overweighting in mortgage-backed securities, a barbell strategy that used long maturity zero coupon Treasuries and high coupon mortgage securities as a package in an attempt to capitalization on the steepness of the yield curve, a market weighting in medium quality corporate securities and a modest exposure in unhedged foreign fixed income securities.

   Beginning in the fourth quarter of 1993, we began to reduce the interest rate exposure of the portfolio. Although the duration of your portfolio at quarter end was 5.9 years, after adjusting for the non-dollar holdings, the relative duration of the zero coupon holdings and the barbell package, the interest rate sensitivity of your portfolio has been reduced to that of the market. For the quarter, the mortgage, foreign and yield curve exposure added to the relative performance of your portfolio, corporate holdings detracted slightly, and the duration decision represented the major negative contribution to overall portfolio results.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   Interest rates have risen approximately 150 basis points over the last two quarters. Prospective real returns offered by long duration, high quality fixed income securities, in our opinion, represent significant value. Consequently, we are looking to opportunistically increase the interest rate exposure of the portfolio by buying more fixed income securities, by reducing the exposure to high coupon mortgages, and replacing the barbell package with call-free bullet fixed income substitutes.

   Although we anticipate further increases in short-term interest rates and moderate increases in long-term interest rates, we believe this shift towards value and the reduction of the barbell strategy within the portfolio will contribute to superior relative performance.

## Miller (con't)

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   During the quarter, we had an increase of 4 new fixed income relationships and both a gain and a loss of 3 separate equity relationships.

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

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## Staff Comments

No comments at this time.

**Manager Commentary**
**Standish, Ayer & Wood**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $22.9 billion | Actual | -3.3% | N/A |
| Total Firm Assets Managed in this Discipline | $11.0 billion | Benchmark | -2.8% | N/A |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

   After a reasonably good January in the bond market, February and March have been as bad as any two back-to-back months we can remember. There were very few islands of superior performance and our numbers suffered accordingly.

   Negative influence was provided by the small position of long strips (0.31%). Though small (less than 5%) the long duration of these instruments hurt performance. Industrials in the corporate sector underperformed the index (0.31%) as most corporate spreads widened. Our mortgages underperformed the index (0.18%) as their duration was longer with concentration in lower coupons. Finally, Yankee bonds (0.09%), a small sector, were sharply under the index as many foreign bonds sold off more sharply than U.S. bonds in our market.

   Balancing these negatives were positive contributions from Non-dollar bonds (0.28%), Treasuries (0.09%) and asset backed securities (0.09%). The Non-dollar sector in SBI actually performed better than our International Fund since the dollar hedge was lighter and some markets which did particularly bad were not represented.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   We have continued to add to mortgage and related securities through the derivative upset of March as spreads are quite wide (100-110 b.p.). This sector including variable rate mortgages, CMO's asset backed securities now equals about 40% of the portfolio. We are reducing our long treasury strip position in favor of intermediates since we believe most of the flattening between the 30 year and 10 year maturity is behind us. In the corporate sector we are weeding out credits which have held up well in favor of others we like which have sold off sharply when we like the fundamentals. We continue to favor Non-dollar securities and plan to gradually add to the sector.

## Standish (con't)

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   There have been no changes in ownership. We will continue to add to personnel as demanded by client need in research, technology staff, administration or portfolio management.

   **Active Core Accounts Gained**

   Pacific Gas & Electric
   Phelps Dodge
   Kresge Foundation

   **Active Core Accounts Lost**

   None

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

   None

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## Staff Comments

No comments at this time.

**Manager Commentary**
**Western Asset Management**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $11.7 billion | Actual | -3.3% | 4.9% |
| Total Firm Assets Managed in this Discipline | $ 6.6 billion | Benchmark | -2.8% | 2.5% |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

The variety of investment strategies we employed over the course of the first quarter produced moderately positive relative results.

Having reduced our duration exposure by year-end to a modest level, we then extended over the course of the quarter as interest rates rose. The negative impact of higher interest rates on performance that this produced was largely, if not completely, offset by our continued barbell exposure to the yield curve, as short and intermediate term interest rates rose substantially more than long-term rates, and spreads on zero coupon bonds which we had also emphasized narrowed significantly.

As corporate spreads continued to narrow early in the quarter, we took the opportunity to further reduce our overexposure to the corporate sector, thus locking in some gains. Our somewhat overweight corporate exposure detracted from performance in the latter part of the quarter, however, as spreads widened. Selected corporate issues registered positive relative performance.

We began the quarter with an underweight exposure to mortgages, and this detracted from performance as mortgage spreads narrowed in January. We then took advantage of wider spreads in March to add to our mortgage exposure, primarily through purchases of government-guaranteed, current-coupon mortgage collateral. Our mortgage exposure detracted somewhat from performance in March as higher interest rates and volatility premiums caused spreads to widen dramatically. We have largely avoided exposure to the more volatile mortgage derivative sector, which helped our relative performance.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

We continue to hold a longer-than-normal duration in the portfolio, in the belief that interest rates have over-reacted to the threat of tighter Fed policy and upward cyclical pressures on interest rates. We also continue to hold a barbell exposure to interest rates, as we feel that long maturities represent excellent value given the low underlying level of inflation we foresee in coming years. If the yield curve continues to flatten, we anticipate reducing our barbell exposure in favor of an emphasis on the intermediate maturity area.

## Western (con't)

We feel that current levels of corporate spreads are attractive, and warrant an ongoing over-weight exposure to the sector. The private sector continues to undergo the restructuring necessary to cope with the current low inflation environment, resulting in healthy debt reduction and balance sheet improvement, all of which lends support to a positive outlook for credit risk.

The extraordinary volatility in the market of late has caused mortgage spreads to widen to historically attractive levels, justifying a modest overweight exposure to this sector as well. We expect that volatility will subside in coming months and valuations will return to more normal levels as it becomes clear that the economy is not growing fast enough to generate the inflation pressures that investors fear, or fast enough to warrant the extreme level of Fed tightening currently built into the forward markets.

We continue to hold a modest position in municipal bonds, despite the recent widening of spreads in this sector which was caused primarily by the sharp backup in yields generally, and by the lingering effects of heavy issuance last year to deface outstanding issues. higher taxes should soon renew investor interest in the sector, and a return to declining intermediate and long-term yields should also increase the attractiveness of munis in general.

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   The only significant ownership/personnel change was the hiring of Laura M. Del Greco as a marketing manager.

   Western Asset added six new accounts in the first quarter. Two of these were in the same discipline as the SBI portfolio. The other new accounts were: one Long Duration, one Limited Duration, one Intermediate Duration and one high yield.

   No accounts were lost during the first quarter.

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

   None.

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## Staff Comments

No comments at this time.

**Manager Commentary**
**IDS Advisory**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $18.4 billion | Actual | -3.4% | N/A |
| Total Firm Assets Managed in this Discipline | $ 4.6 billion | Benchmark | -3.1% | N/A |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

   The most significant investment decision made by IDS in the quarter and nine months was to maintain portfolio duration near the high end permitted by investment guidelines. This decision was not beneficial because the nine months and the most recent quarter in particular were periods of rising interest rates. While your account underperformed the benchmark by 0 3 of one percent in the quarter, it has outperformed the benchmark by essentially an identical amount over the past nine months.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   With inflation as measured by the CPI remaining under 3% thus far in 1994, we believe that real long term interest rates of 4 to 5% represent excellent value. However, Alan Greenspan and the Federal Reserve Board have concluded that they agree with the many who have historically believed that rising economic activity always meant increased inflation. In February and March 0.25% increases in Fed Funds rates were instituted. The market wasted little time in responding to each of these moves and interest all across the yield curve rose dramatically. In early march we began to raise cash in your portfolio. Duration as a result, has been reduced by two years and is now close to the mid-point allowed by investment guidelines. This response by us to the FRB actions is because of our belief that Alan Greenspan with his gradualist tendencies will continue to raise short-term interest rates until he is satisfied that domestic economic activity has no change of increasing in an uncontrolled manner. Additional short-term interest rate increases are expected by us. This should enable us to beneficially re-deploy the 25% cash at a later date.

## IDS (con't)

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

There have been no ownership or personnel changes at IDS Advisory Group in the last quarter.

| | Gains | | Losses | |
|---|---|---|---|---|
| **Product** | **# of Accts** | **Assets ($MM)** | **# of Accts** | **Assets ($MM)** |
| Large Cap Equities | 0 | 0 | 1 | 2.9 |
| Fixed Income | 2 | 103.1 | 0 | 0 |
| Balanced | 4 | 24.3 | 0 | 0 |
| International | 0 | 0 | 2 | 317.6 |
| Small Cap Equities | 0 | 0 | 0 | 0 |
| Mid Cap Equities | 0 | 0 | 0 | 0 |
| Research Core | 0 | 0 | 0 | 0 |
| Research Aggressive | 0 | 0 | 0 | 0 |

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None at this time.

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### Staff Comments

No comments at this time.

**Manager Commentary**
**TCW Asset Management**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $49.3 billion | Actual | -1.7% | N/A |
| Total Firm Assets Managed in this Discipline | $14.0 billion | Benchmark | -2.1% | N/A |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

   For the first quarter of 1994, the return on the Minnesota State Board Mortgage-Backed Portfolio was -1.53%. This compared very favorably to the Lehman Government/Corporate Index return of -2.03% and the Salomon Mortgage index return of -2.10%. The performance of the fixed income market in general was poor during the first quarter due to the large increase in interest rates during the last two months. Our strategy of investing in CMO securities enabled us to outperform the market. As rates rose over the quarter, prepayment rate forecasts on mortgage securities declined and the duration of the mortgage market extended from 3 to 5 years. However, your CMO holdings did not extend nearly as much, and therefore we outperformed. Furthermore, we realized some gains by selling securities during the quarter.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   We continue to emphasize CMO securities that provide protection from extension risk in rising rate environments and protection from call risk in falling rate environments. This strategy allows us to outperform the market in a wide variety of market conditions.

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   There were no ownership or personnel changes in the first quarter.

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

   Our current outlook for the mortgage-backed securities market is favorable. We are now able to purchase GNMA 8.00%'s at par, a rate which compares very favorably to the historic long-term rate of return on the stock market. The recent abrupt increase in interest rates caught some investors by surprise and forced them to liquidate positions and take losses. Market volatility increased and mortgage spreads widened. However, fundamentally little has happened to warrant this rate increase, and therefore feel this is an excellent time to purchase securities and to consider allocating additional funds to the mortgage sector.

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**Staff Comments**

No comments at this time.

## Manager Commentary
## Goldman Sachs Asset Management

| Period Ending: | 3/31/94 | Returns | Qtr. | Year |
|---|---|---|---|---|
| Total Firm Assets Under Management | $48.8 billion | Actual | -2.6% | N/A |
| Total Firm Assets Managed in this Discipline | $15.0 billion | Benchmark | -2.8% | N/A |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

The portfolio outperformed the Salomon BIG by 11 basis points in the first quarter. This performance can be attributed to several main factors:

| | | |
|---|---|---|
| Mortgage Sector | +7 | bps |
| Incremental Yield | +6 | |
| Curve Exposure | +4 | |
| Municipal Cross-Over Trade | -4 | |
| Corporate Sector | -4 | |
| Other | 2 | |
| **Total** | +11 | bps |

Mortgages contributed the largest share of the outperformance, 7 bps, mainly as a result of the spread tightening of the securities we selected compared with those in the index. In particular, the overweighting of premium mortgages added substantially to the return of the portfolio, as they outperformed lower coupon mortgages due to an expected slowdown in prepayments. The portfolio's return increased 4 bps from the performance of the CMO, which outperformed comparable-duration Treasury securities by about 2.9% over the quarter.

Across sectors, we gained about 6 bps due to the incremental yield of the securities we held in the portfolio versus those in the index.

The portfolio's yield curve exposure in March accounted for another significant portion of the incremental return of the portfolio, adding about 4 bps. Our strategy overweighed the 20- and 30- year parts of the curve and underweighted 10-year maturities. The yield on the 30-year sector rose about 35 bps less than the yield on the 10-year sector, thus contributing about 4 bps to the differential return of the portfolio.

The two factors that detracted from the performance of the portfolio over the quarter were our positions in municipals and in corporates. The municipal trade, which contributed 6 bps to performance in the last quarter, retraced 4 bps of that gain. We also lost about 4 bps in the corporate sector. This was mainly due to our overweighting of triple Bs as credit spreads widened, and our overweighting of the cable/media subsector, which weakened as a result of negative events such as the collapse of the Bell Atlantic and TCI merger discussions.

## Goldman (con't)

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   **Duration and Yield Curve Exposure:**
   Given the likelihood of further monetary policy tightening and continued volatility in interest rates, we have a relatively neutral outlook for interest rates, with a bias to be slightly short. We are matching the duration of the fund to that of the benchmark, as well as maintaining a neutral yield curve exposure.

   **Mortgages**
   Among sectors, we are neutral on mortgage spreads but continue to slightly overweight the sector due to the incremental yield and opportunities for relative value trading it offers. We are overweighting lower coupon GNMAs versus conventional mortgages because of the attractive relative spreads GNMAs offer. We believe the yield spread on the GNMAs compensates investors for the extension risk in these securities. In the premium GNMA sector, we expect to add value as a result of our swap from 1990-1991 issues into 1986-1987 issues, which offer greater prepayment certainty in a volatile market.

   **Corporates**
   We remain cautiously positive on the outlook for corporate spreads going forward. Despite the recent increase of event risk, the fundamentals for the economy, corporate profits, and credit quality are solid. As a result, we remain overweighted in the sector as a whole. Within the corporate sector, we are maintaining an overweighting in the cable/media subsector, as we believe recent concerns over event risk have been exaggerated. Specifically, TCI, News Corp., and Time Warner debt should tighten as the market reassesses the fundamental value they offer. We also expect the tensions in Korea to diminish without resort to a military conflict, as all parties have an interest in a political solution. Korean debt should return to fair value, which we believe is a spread 40-50 bps tighter than at present.

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   - There were no changes in the ownership of Goldman Sachs Asset Management.
   - GSAM had two changes in our U.S. fixed income portfolio management staff: The addition of Richard Buckholz to develop our Emerging Markets Group and the resignation of Adam Wizon from our Portfolio Strategy & Risk Control Group.
   - Fixed Income Accounts Gained: U.S. Tax-Exempt Clients - 2; Non-U.S. Client - 1;
   - Fixed Income Accounts Lost: Non-U.S. Client - 1

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

   None

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**Staff Comments**

No comments at this time.

**Manager Commentary**
**Fidelity Management Trust Company**

| Period Ending: | 3/31/94 | Returns | Qtr. | Year |
|---|---|---|---|---|
| Total Firm Assets Under Management | $20.8 billion | Actual | -2.5% | 3.6% |
| Total Firm Assets Managed in this Discipline | $ 5.7 billion | Benchmark | -2.8% | 2.5% |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

   - The portfolio outperformed the Salomon Broad Investment-Grade Index during the quarter. The portfolio's sector allocation was the primary contributor to the positive relative performance.
   - The portfolio's corporate sector overweighting helped performance. The overall sector benefited from general improvements in the economy. Emphasis in lower quality corporates also added to relative returns. Lower quality corporate credits benefit more so than higher quality credits during economic upswings.
   - The portfolio's Collateralized Mortgage Obligations performed strongly as a result of the expectation of slower prepayments. Also benefiting from revised prepayment estimates, an increased allocation to mortgage pass-through securities also helped the portfolio.
   - Municipal holdings, however, suffered over the quarter from technical factors caused primarily by the back-up in the Treasury market.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   <u>**Corporates**</u>

   - Given a rich domestic corporate market, we continue to seek alternatives to traditional corporate issues. We have added surplus notes and Mexican Yankees.
   - We continue to maintain an overweighted position on a market value basis, with a neutral dollar duration exposure relative to the Index.

   <u>**Municipals**</u>

   - We have recently scaled out of the crossover trade (owning high quality municipals versus Treasuries). We will look to put the trade back on as yield ratios widen back out again.

   <u>**Mortgages**</u>

   - We remain overweighted in mortgages (primarily discount pass-throughs) versus Treasuries.
   - Within the mortgage market we prefer GNMA's versus conventionals.

## Fidelity (con't)

Yield Curve

- Moderately barbelled term structure exposure.
- We expect a further flattening of the yield curve as the Fed continues to raise rates, and inflation expectations decline.

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

FMTC lost one Fixed Income client during first quarter of 1994. The market value of the account at time of departure was $32.7 million.

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None

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**Staff Comments**

No comments at this time.

**Manager Commentary**
**Lincoln Capital Management Company**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $26.2 billion | Actual | -2.6% | 2.7% |
| Total Firm Assets Managed in this Discipline | $ 9.2 billion | Benchmark | -2.8% | 2.5% |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

| | 1st Quarter 1994 | | 12 Months Ended 3/31/94 | |
|---|---|---|---|---|
| | Active Strategy | Value Added | Active Strategy | Value Added |
| Mortgages | Overweighted | +0.04% | Overweighted | +0.04% |
| Corporates | Underweighted | 0.00 | Underweighted | 0.00 |
| BBBs | Underweighted | 0.00 | Underweighted | -0.02 |
| Asset-Backed | Overweighted | +0.02 | Overweighted | +0.04 |
| Agencies | Overweighted | 0.00 | Overweighted | 0.00 |
| Miscellaneous | | | | |
| Rebalancing Transaction Cost | N/A | -0.01% | N/A | -0.04% |
| Contribution Transaction Cost | N/A | 0.00 | N/A | -0.07 |
| Security Selection | N/A | +0.01 | N/A | +0.17 |
| **Total** | | +0.06% | | +0.12% |

The very high interest rate and spread volatility during the quarter favorably impacted security selection opportunities across the mortgage and Treasury sectors. Asset-backed slightly outperformed other sectors. The modest asset-backed overweighting positively impacted portfolio returns during the quarter. For the year, the largest drag on returns was due to the one time transaction costs associated with the 7/01/93 contribution of $330 million.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

| Future Strategy | Strategy | Rationale |
|---|---|---|
| Government Trust Certificates | Overweighted vs. Treasuries | 1. Government Guarantee<br>2. Attractive Yield<br>3. Certain Cash Flow |
| Asset-Backed | Overweighted vs. Treasuries and Corporates | 1. High Quality<br>2. Attractive Yield<br>3. Low Event Risk<br>4. Low Prepayment Risk |
| Current Coupon Mortgages | Overweighted vs. Treasuries | 1. Agency Quality<br>2. Low Prepayment Risk<br>3. Wide Nominal Spreads<br>4. Deferred Settlement |
| High Coupon Moderately Seasoned GNMA Mortgages | Overweighted vs. Conventionals | 1. Lower Prepayment Risk<br>2. Much Higher Yield |

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

| | Number | Market Value ($ millions) |
|---|---|---|
| Accounts Gained | 0 | N/A |
| Accounts Lost | 0 | N/A |

There have been no ownership or personnel changes.

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

There are no issues or developments that would impact the SBI account.

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**Staff Comments**

No comments at this time.

## Manager Commentary
## Baring Investment Services

| Period Ending: | 3/31/94 | Returns | Qtr. | Year |
|---|---|---|---|---|
| Total Firm Assets Under Management | $10.8 billion | Actual | -3.6% | N/A |
| Total Firm Assets Managed in this Discipline | $ 1.0 billion | Benchmark | 3.5% | N/A |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

The following figures give a breakdown of these returns:

| | Total Return % | Market Currency % | Tracking Weighting % | Error % |
|---|---|---|---|---|
| Minnesota State Board | -3.6 | 2.3 | -5.4 | -0.3 |
| MSCI EAFE Free Index | 3.4 | 5.2 | -1.7 | -- |
| Relative Return | -6.8 | -2.8 | -3.8 | -0.3 |

The relative contributions to return from currency, markets, and tracking error were all negative during the quarter.

The negative contribution to return from currency was mainly due to our underweight position in the Yen which rose by 8.6% against the Dollar. In a quarter when the US Dollar was generally weak our overweight position in the Dollar related currencies of S.E. Asia also had a negative impact. Within market weight, our underweight position in Japan and our overweight positions in S.E. Asian markets were the main reason for the underperformance from our allocation to markets. The stockmarkets in Hong Kong, Malaysia and Thailand fell by 23.1%, 25.3% and 25.6% respectively while the Japanese market rose by 7.1%. Our average weighting in Japan during the quarter was 23% while our average weighting in S.E. Asia was 22%. The tracking error is primarily due to Singapore where the premium associated with the market was not fully reflected in the Index return.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

The main features of your portfolio are:-
Overweight position in Hong Kong and Singapore;
Underweight in Japan;
Underweight in Europe;
Approximately 11.7% exposure to the non-Index markets of Thailand, Mexico, and Korea;
8% of the Fund hedged back into the US Dollar from the Swiss Franc and Yen.

## Baring (con't)

In a background of rising interest rates and falling market multiples we are focusing our investments in markets where there is clearer visibility of corporate earnings recovery. We have, therefore, increased our weightings in Canada, Australia, and the United Kingdom as the economic recovery in all these countries is well under way and continues to surprise economists by its strength. We remain underweight in markets where recovery at best is weak and at worst remains a hope such as Japan and Germany. In Germany it has become increasingly clear that economic growth in 1994 will be negative. Wage growth is now virtually non-existent and the only hope for recovery would be from significant reductions in interest rates.

In Japan the structural problems of inefficient industries are gradually being addressed. The economy has probably bottomed out but earnings recovery to March 1995 is unlikely to be strong enough to support the current multiple of 75x, which is the level of where the market has been driven by the strong buying from overseas investors in the first quarter of this year.

In S.E. Asia the extent of the growth continues to surprise forecasters but the falls in these markets in the first quarter were not about growth, they were about valuation and risk. Valuations are now more attractive and the severe overbought portion has been eradicated. We remain overweight in Hong Kong, Singapore, Thailand and Korea.

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   --Accounts Gained: New York Teamsters
   --No significant ownership or personnel changes.

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

   None.

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## Staff Comments

Staff met with Philip Bullen at SBI offices on March 24, 1994 for a general portfolio update. The presentation largely confirmed the summary given above in terms of strategy as results over the year since the Barings was first funded.

The firm has gained a significant number of active/passive clients since they were retained by the SBI. Barings maintains that this growth has presented no organizational concerns since asset management is implemented through State Street Bank country funds.

Barings is increasing its staff in the U.S. In the future two of the 10 members of the Strategic Policy Team will be located in Boston. They intend to increase their client service staff in the U.S. in order to lessen the workload of the designated portfolio managers both in the U.S. and the U.K.

## Manager Commentary
## Brinson Partners, Inc.

| Period Ending: | 3/31/94 | Returns | Qtr. | Year |
|---|---|---|---|---|
| Total Firm Assets Under Management | $35.0 billion | Actual | -0.2% | 10.2% |
| Total Firm Assets Managed in this Discipline | $ 6.6 billion | Benchmark | 3.5% | 22.5% |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

   Market allocation proved favorable during the first quarter as the smaller Southeast Asian markets, Hong Kong, Singapore and Malaysia, declined by more than 20% and the SBI portfolio has little exposure in this region. For the year, this exposure hurt performance. Our 10% underweight in Japan helped performance in 1993 but hurt in the first quarter of 1994. The 10% cash hedge was a drag on performance in 1993 as many markets rallied but protected against negative market returns in the first quarter. Currency strategies hurt performance as the yen continued to rise and the Canadian dollar continued to fall.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   At the end of March, the allocation to Japan was 35.8%, compared with a benchmark weight of 45.8%. While the valuations for Japan have improved, the market is still trading above fair value and is overvalued relative to other equity markets. Our economic outlook for Japan remains negative.

   Within the All Other Markets segment, the portfolio has been overweighted in Australia, Canada and the Netherlands. We continue to believe they display more attractive price/value relationships than other equity markets. We also continue to overweight Belgium, Spain and New Zealand. We are carrying a moderate overweight in the U.K., where relative valuations are becoming more attractive. We recently increased the size of our underweight in Hong Kong and Germany. While the economic boom in China continued to feed interest in Hong Kong companies, the risks of an overheated Chinese economy and an uncertain political situation are being underestimated by the market. The German equity market performed well in 1993, despite a deepening recession, with a bleak outlook for corporate earnings. Many German companies are struggling with a loss of competitiveness, particularly against some of their European competitors.

   The strategic cash position of the portfolio is 10%, which represents the maximum of our normal range of 0-10%. The maximum allocation to cash reflects our view that non-U.S. equity markets are overvalued, albeit by varying degrees. The strong rise in prices in 1993 was worrisome since it was generally not accompanied by a fundamental improvement in earnings.

## Brinson (Con't)

The portfolio maintains a significant underweight in the yen (-32%). The portfolio maintains minimal exposure to the overvalued core ERM currencies. The portfolio currently maintains a 21% allocation to the Canadian dollar and a 28% allocation to the U.S. dollar. The Canadian currency is trading below fair value and short term interest rates in Canada remain above these in the U.S. In our judgment, the Canadian dollar cash return remains attractive as compared to the U.S. dollar and other currencies.

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   We are pleased to report that our employee ownership of the firm has increased from 62% to 76% this year due to our purchase of a portion of minority shareholders' equity holdings. We believe that employee participation in the economics of our firm characterizes our commitment to the highest quality investment management and client.

   | | | |
   |---|---|---|
   | Gained: | 7 accounts | $141 million |
   | Lost: | 0 accounts | 0 |

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

   None of significance in this quarter.

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## Staff Comments

No additional comments at this time.

**Manager Commentary**
**Marathon Asset Management**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $1.4 billion | Actual | 9.8% | N/A |
| Total Firm Assets Managed in this Discipline | $0.3 billion | Benchmark | 3.5% | N/A |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

   The portfolio rose 9.80% during the first quarter of 1994 versus a 3.56% gain in the MSCI EAFE Index. Stock returns were positive in all major markets with soft currency Europe (UK and Scandinavia) continuing to experience strong rebounds in smaller capitalization and cyclically depressed areas. The S.E. Asian markets experienced sharp consolidations following their heady rises last year whilst the Japanese market rebounded despite renewed yen strength and further political uncertainty as attention focused on the prospects for sustainable economic recovery. Changes in the Fund's geographical distribution were due to relative market movements and no major shifts in country allocation are planned.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   The Fund remains underweight in Europe (39.2% versus an index weighting of 45.7%) as the region is likely to be severely tested by developments - rising interest rates and the likelihood of a stronger dollar and reduced international equity investment flows - from the U.S. Within Europe the heavy overweighting of the portfolio in the soft currency bloc will gradually be reduced with weightings raised in those markets (Germany, Holland, Italy and, to a lesser degree, France) that have maintained high real interest rates, where the equity supply-demand balance is becoming increasingly attractive and where glimmers of hope are beginning to appear amidst the gloom of economic recession.

   The key question facing the Fund in Asia is whether the corrections seen in the first quarter were healthy consolidations in long-term bull runs or the final speculative froth that presages drawn out bear markets. Whilst growth rates and P/E's in many cases remain attractive and would argue for the former, asset prices and liquidity conditions have shown all the symptoms of the latter. Clearly expectations ran ahead of events and the quality of stocks that led these markets in the second half of 1993 (speculatives, trading counters and leveraged asset plays) suggests that further digestion may be necessary. The bias of the portfolio outside Japan remains then largely unchanged, focusing on resources and growth defensives.

   The Japan weighting rose from 35.2% to 41.6% over the quarter, but stock and sector concentration has actually been increased reflecting a growing belief that long-term earnings growth (as against cyclical recovery) will be increasingly rerated as domestic institutional investors turn net buyers. Holdings are hence focused on large capitalization domestic beneficiaries of structural market liberalization and deregulation, smaller domestic niche companies that are immune from rising import substitution and market pricing pressures, and well managed exporters that have shown an ability to cope with (and, if possible, benefit from) yen appreciation.

## Marathon (con't)

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   No personnel changes.

   Clients gained (EAFE mandate): 3M, Honeywell.

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

   No issues raised during quarter.

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## Staff Comments

No additional comments at this time.

**Manager Commentary**
**Rowe Price-Fleming International**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $16.1 billion | Actual | -2.6% | N/A |
| Total Firm Assets Managed in this Discipline | $10.7 billion | Benchmark | 3.5% | N/A |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

   **Country allocation** was responsible for most of the underperformance relative to EAFE over the quarter. The most important features were:

   - Underweight in Japan (20% of your portfolio as against 44% of the index) accounted for half of the value subtracted.

   - Overweight in the Pacific ex-Japan (22% of your portfolio as against 10% of the index) accounted for another 40% of the value subtracted.

   - Holding Mexico at 5% of your portfolio over the quarter: Mexico is not in the index and its weak performance hurt relative returns.

   **Positive stock selection** off-set some 10% of the value subtracted by country allocation. In particular, good stock selection was recorded in Continental Europe where an underweight position in interest rate sensitive stocks was beneficial.

   **Currency hedging,** primarily the 5% cross-hedge out of European currencies into the yen, added value given the strength of the Japanese currency over this period.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   **Countries** - Despite the gloom resulting from the change in interest rate policy in the USA, we are optimistic on international markets for the reminder of 1994. We expect economic activity to improve around the world as we head towards the Summer. We do not believe that interest rates outside the USA are likely to rise further over the balance of the year. Finally, after recent falls, we find equity valuation levels more acceptable in most markets particularly against bonds.

   Reflecting this overview, we continue to emphasize those areas where economic recovery has been most delayed and where valuations are most reasonable (in particular Continental Europe) together with those smaller economies in the emerging areas of the world which will see strong economic growth continuing this year. That said, we are likely to continue to edge up exposure to Japan and this is likely to be funded from the UK and South East Asia.

## Rowe Price (con't)

**Stocks** - Against the benchmark, we continue to underweight the financial sector and overweight the consumer and capital goods areas. This bias away from interest rate sensitive stocks is likely to continue as we build up further in both large and smaller growth stocks which are likely to benefit from economic recovery world-wide.

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   There have been no changes in either ownership or personnel in the first quarter.

   During the quarter, RPFI gained one new account with a fully international mandate.

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

   None.

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## Staff Comments

Staff met with David Warren and Chip Wendler at SBI offices on March 9, 1994 for a general portfolio update. The presentation largely confirmed the summary given above in terms of strategy and results to date.

## Manager Commentary
## Scudder, Stevens and Clark

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $90 billion | Actual | -3.3% | N\A |
| Total Firm Assets Managed in this Discipline | $ 6 billion | Benchmark | 3.5% | N/A |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

The first quarter of 1994 was a rough period for financial markets. Most of the major equity markets (the U.S., Germany, the U.K., France) declined during the quarter. Aside from Japan, the only ones that managed to post gains were the smaller markets like Italy, Finland, Greece and Norway. These markets are very illiquid and we can not participate in them to any great degree. As a result of these poor market conditions, the value of your portfolio slipped 3.3% in the first quarter of 1994.

By contrast, the EAFE index, which is our benchmark, rose 3.5% over that period. The primary reason for the increase was the Japanese market, which rose 9.7% during the quarter and was helped further by the strengthening of the Yen, Japan accounts for a disproportionately large portion of the EAFE index (roughly 45%). One could argue this caused the EAFE index to send out potentially-misleading signals. Price declines in EAFE were the general rule of the day.

The sell-off in most global financial markets was triggered by the Federal Reserve raising short term interest rates. We were in the process of increasing our Japanese weighting and trimming back on European financial when the first rate hike took place. So we were hurt, in part, to the extent that we were underweighted in Japan and had not yet completed shifting our portfolio around.

In addition, we have, for quite some time, maintained an overweight position in the Southeast Asian markets. This strategy served us very well in 1993, when the Southeast Asian markets were among the top performers in the world. Unfortunately, that made these same markets ripe for profit taking. When sentiment turned negative, the Southeast Asian bourses were among the hardest hit. Having said that, we are still very positive on Southeast Asia. This is the fastest growing region in the world, bar none, Real GDP growth has consistently run between 6-10% range per annum in most countries, inflation, is low and corporate profits have been exploding.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

We have increased our weightings in Japan significantly. The reason for this is that we see some fundamental changes taking place in that country that, we feel, will transform it for the better. On the political front, we've seen the LDP's stranglehold on power finally broken and that has far-reaching implications. Whoever wishes to hold office in Japan from now on will have to be more sensitive to the needs to the electorate. No longer can big business and industry prosper at the expense of the Japanese consumer. We are also seeing Japanese starting to restructure themselves, putting more emphasis on cutting costs. In time, we feel these events will result in a more efficient, more open Japanese economy. Having said that, however, we remain underweight in Japan relative to EAFE, because we do not know at what pace these economic and political reforms will take place.

We have increased our weightings in cyclicals. The U.S. economy is well into the recovery phase and Europe is starting to show signs of turning around. Even in Japan, we feel the worst is over and going into 1995, we are looking for a synchronous pickup in global economic activity.

As stated earlier, we cut back on European financial stocks. We felt that the bulk of interest cuts were behind us and any further cuts in European interest rates that may have been forthcoming had already been factored into the market. We have top-sliced a bit in Southeast Asia but still maintain an overweight position. As stated earlier, this remains the most dynamic region in the world in terms of economic growth.

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

Departed:
Andrew Economos (Managing Director) and Pacific basin product manager
replaced by Elizabeth Allen (former manager of the Japan Fund)

Additions:
Francisco Rodrigo - Int'l Portfolio Manager
Lois Friedman - Pharmaceuticals Analyst

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

None.

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## Staff Comments

Staff met with Nick Bratt at SBI offices on April 15, 1994 for a general portfolio update. The presentation largely confirmed the summary given above in terms of strategy and results to date. While they are seeking new clients for their emerging markets trust, Scudder has essentially "closed its doors" to new clients for EAFE mandate for the time being. Staff views this as a positive move for the firm since Scudder had experienced significant client and asset growth over the last two to five years.

**Manager Commentary**
**Templeton Investment Counsel, Inc.**

| **Period Ending:** | **3/31/94** | **Returns** | **Qtr.** | **Year** |
|---|---|---|---|---|
| Total Firm Assets Under Management | $35.5 billion | Actual | 1.3% | N/A |
| Total Firm Assets Managed in this Discipline | $ 8.9 billion | Benchmark | 3.5% | N/A |

1. ***Past Performance.*** *Summarize your performance over the last quarter and year. Specifically, what active bets did you make relative to your benchmark? Which of these bets worked/did not work and why?*

   The MSCI EAFE index posted a 3.6% return for the first quarter and year to date. Your account gained 1.5% for the quarter and year to date. The most significant issue for your account continues to be our relative underweighting of the Japanese market which posted a gain of 16.7% in dollar terms. Currently our exposure to Japan stands at approximately 4.6% vs. its 44% weight in the index. This underweight, causes us to overweight Europe. Within Europe our overweights have been in Sweden, Spain, Italy, Finland, Switzerland and Norway, while our European underweights have been in Germany, France and the UK. We hold a slight overweight to Hong Kong which has declined by some 23% in dollar terms for the quarter. Interestingly, EAFE ex Japan declined by 4.7% for the quarter and the year to date.

2. ***Future Strategy.*** *What active bets are in place at the present time relative to your benchmark? Summarize the rationale for making these active bets.*

   As we are bottom up managers, our active bets are driven by our stock picking process. At this point in time your portfolio looks much the way it did in the first quarter. However, going forward we are likely to increase our weights toward those markets which have sold off or significantly under performed. Given this, we will likely increase, over time, our exposure to Hong Kong and Mexico as we are now finding an increasing number of opportunities.

## Templeton (con't)

3. ***Organizational Issues.*** *Describe any significant ownership or personnel changes at the firm over the last quarter. List accounts gained and lost in this discipline over the same time period.*

   We have added four research analysts to our firm in the last quarter.

   We have gained two separate Non-US Equity accounts in the first quarter of 1994 totaling $53 million. We have also gained approximately $150 MM in our Templeton Institutional Funds, Inc. Foreign Equity Series in the first quarter of 1994.

4. ***Other Comments.*** *Highlight any other issues/events that are pertinent to the management of the SBI account at your firm.*

   None.

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## Staff Comments

None at this time.

# STATE BOARD OF INVESTMENT

## Addendum to the Meeting Materials for June 8, 1994:

## Proposed Deferred Compensation Contracts

- Annuity Contract and Letter Agreement with Great-West
- Annuity Contract and Business Agreement with Minnesota Mutual
- Service Agreement with National Benefits
- Service Agreement with Ochs Services Agency

# Annuity Contract and Letter Agreement with Great-West

# FuturFunds™

## APPLICATION FOR GROUP DEFERRED COMPENSATION ANNUITY CONTRACT

Exact Name: State Board of Investment (herein called SBI or Group Policyholder) and Minnesota State Retirement System (herein called MSRS or Group Policyholder) on behalf of the State of Minnesota and all employers participating in the State of Minnesota Deferred Compensation Plan apply to Great-West Life & Annuity Insurance Company for a Group Deferred Compensation Annuity Contract (herein called the Group Annuity Contract) in the form of the copy attached to this Application. It is agreed that the Group Policyholder will accept the Group Annuity Contract when issued.

Specify the effective date of the Group Annuity Contract: **September 1, 1994**

Specify the name of the Deferred Compensation Plan: **State of Minnesota Deferred Compensation Plan**

This Group Annuity Contract is only available to policyholders whose Deferred Compensation Plan is an eligible State deferred compensation plan described in Section 457(b) of the Internal Revenue Code of 1986, as amended.

The Insurance Company requires that a copy of the currently effective plan document accompany this application, for its information.

PAYMENTS AND VALUES PROVIDED BY THIS CONTRACT MAY INCREASE OR DECREASE AND ARE NOT GUARANTEED AS TO DOLLAR AMOUNT.

Group Policyholder's address The State Board of Investment, Suite 105, MEA Bldg., 55 Sherburne Ave., St. Paul, MN 55155

Dated at ______________________ this ________ day of ______________________, 19_____

The Deferred Compensation Plan ("Plan") to which a Group Annuity Contract is offered by Great-West Life & Annuity Insurance Company hereby represents the following:

1. The Plan is not funded by an annuity contract described in Section 403(b) of the Internal Revenue Code of 1986, as amended ("the Code").
2. No employee contributions to the Plan will be invested by the Plan in securities of the employer or its controlled or commonly controlled entities.
3. The Plan is for the exclusive benefit of the employees and beneficiaries and the purpose of the Plan is the distribution of funds accumulated under the Plan to employees or their beneficiaries.
4. No part of the assets of the Plan shall be used or diverted to any purpose other than for the benefit of the employees or their beneficiaries prior to the satisfaction of all the Plan's liabilities to the employees and beneficiaries. However, to the extent necessary to retain qualification under Section 457 of the Code, these assets shall remain subject to the claims of the general creditors of the employer.

State Board of Investment and Minnesota State Retirement System on behalf of the State of Minnesota and all employers participating in the State of Minnesota Deferred Compensation Plan
Group Policyholder

By ______________________
Signature

______________________
Title

Application
Group Deferred Compensation Annuity
G620

CB4856B.PER

GREAT-WEST LIFE & ANNUITY INSURANCE COMPANY
HOME OFFICE - ENGLEWOOD, COLORADO
ADMINISTRATIVE OFFICES
ENGLEWOOD, COLORADO

| | |
|---|---|
| GROUP POLICYHOLDER | State Board of Investment and Minnesota State Retirement System on behalf of the State of Minnesota and all employers participating in the State of Minnesota Deferred Compensation Plan |
| GROUP POLICY NUMBER | 88300-01 |
| GROUP ANNUITY CONTRACT DATE | **September 1, 1994** |

Group Deferred Compensation Annuity, Non-Participating

The provisions on the following pages, together with the Application for this Group Annuity Contract, are part of this Group Annuity Contract.

For the purposes of this Group Annuity Contract, "Plan" means the plan and adoption agreement that the Group Policyholder has designated as the State of Minnesota Deferred Compensation Plan.

Signed for the Great-West Life & Annuity Insurance Company on the issuance of the Group Annuity Contract on the Annuity Contract Date.

Vice President & Secretary

President

For the Actuary

This Group Annuity Contract is a legal contract between the Group Policyholder and the Great-West Life & Annuity Insurance Company. PLEASE READ THIS ANNUITY CONTRACT CAREFULLY. IT IS A CONTRACT WHICH MAY PROVIDE FOR PAYMENTS OR VALUES WHICH ARE NOT GUARANTEED AS TO FIXED-DOLLAR AMOUNT BUT MAY INCREASE OR DECREASE ACCORDING TO THE INVESTMENT EXPERIENCE OF A VARIABLE ANNUITY ACCOUNT.

Group Deferred Compensation Annuity

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SECTION 1. DEFINITIONS

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|---|---|
| Accumulation Period | - the period during which the Participant is covered under this Group Annuity Contract prior to the Participant's Annuity Commencement Date. |
| Accumulation Unit | - an accounting measure used to determine the Variable Contract Value before the Annuity Commencement Date. |
| Administrative Offices | - 8505 East Orchard Road, Englewood, Colorado 80111. |
| Annuitant | - the person upon whose life the payment of an annuity is based. |
| Annuity Commencement Date | - the date on which annuity payments commence under a payment option, which for any Participant is the date required under the Group Policyholder's Plan. Notwithstanding the immediately preceding sentence, the Participant's Annuity commencement Date will never be later than April 1 of the calendar year following the calendar year in which the Participant attains the later of:<br><br>A. Age 70 1/2, or<br>B. Separation from service. |
| Annuity Payment Period | - the period during which the Participant is covered under this Group Annuity Contract after the Participant's Annuity Commencement Date. |
| Annuity Unit | - an accounting measure used to determine the dollar value of any Variable Dollar Annuity Payment after the first annuity payment is made. |
| Company | - the Great-West Life & Annuity Insurance Company. |

SECTION 1. DEFINITIONS (continued)

| | | |
|---|---|---|
| Deposit | - | includes contributions, transfers and other amounts deposited into Guaranteed or Variable Sub-Accounts. |
| Eligible Fund | - | a registered management investment company in which the assets of the Series Account may be invested. |
| Group Annuity Contract Date | - | the effective date indicated by the Group Policyholder on the Application for this Group Annuity Contract, or such other date which is acceptable to the Company. |
| Group Policyholder | - | the employer of a Participant and the applicant for this Group Annuity Contract. |
| Guaranteed Account | - | the portion of this Group Annuity Contract providing Guaranteed Sub-Accounts, each having a Guaranteed Interest Rate and containing fixed dollar amounts. |
| Guaranteed Contract Value | - | the sum of the values of the Guaranteed Sub-Accounts credited to the Group Policyholder in respect of a Participant under a Participant Annuity Account. |
| Guaranteed Interest Rate | - | the minimum interest rate applicable to Guaranteed Sub-Accounts which on an annual effective basis is 4%. |
| Guaranteed Sub-Account | - | a subdivision of the Guaranteed Account having a Guaranteed Interest Rate. This subdivision is described in greater detail in the attached Guaranteed Sub-Account Riders, if any. |
| Investment Division | - | a division of the Series Account containing the shares of a specific portfolio of the Eligible Fund. There is an Investment Division for each portfolio of the Eligible Fund. |

SECTION 1. DEFINITIONS (continued)

| | | |
|---|---|---|
| Intra-Company Transfer | - | amounts moved within and between the currently offered Variable and Guaranteed Sub-Accounts upon each Written Request of the Group Policyholder on behalf of the Participant. |
| Letter Agreement | - | a formal written agreement signed by the Company and the Group Policyholder which is used to clarify or modify certain provisions of the Contract and will be attached to and form a part of this Group Annuity Contract. |
| Participant | - | an employee who has met the eligibility requirements under the Plan and for whom the Group Policyholder has applied for coverage. |
| Participant Annuity Account | - | a separate record in the name of each Participant which reflects the total of the Guaranteed and Variable Contract Values. |
| Participant Annuity Account Value | - | the sum of the Variable and Guaranteed Contract Values credited to the Group Policyholder in respect of a Participant under a Participant Annuity Account. |
| Participant Effective Date | - | the date on which the first Deposit is credited to a Participant Annuity Account. |
| Payee | - | the Group Policyholder or the person, including the Participant, designated to receive the value of the Participant Annuity Account. |

SECTION 1. DEFINITIONS (continued)

| | | |
|---|---|---|
| Plan | - | the underlying plan document of the Group Policyholder written in accordance with Section 457 of the Internal Revenue Code. Although the Company may have knowledge of certain provisions of the Plan, the legal sufficiency of the Plan remains solely the responsibility of the Group Policyholder. Should any provisions of the Plan and this Contract be in conflict, the provisions of this Contract shall prevail. |
| Plan-To-Plan Transfer | - | amounts moved from any Variable or Guaranteed Sub-Account to another eligible deferred compensation plan upon Written Request from the Group Policyholder on behalf of a Participant. |
| Premium Tax | - | the amount of tax, if any, charged by a state or other governmental authority on premiums. |
| Series Account | - | the FutureFunds Series II Account, a segregated investment account established by Great-West Life & Annuity Insurance Company under Colorado law. |
| Transfer to Other Companies | - | amounts moved from any Variable or Guaranteed Sub-Account to another company upon each Written Request from the Group Policyholder on behalf of the Participant. |
| Valuation Date | - | the date on which the net asset value of each Eligible Fund is determined, which day may vary depending upon the day which any given Eligible Fund may be purchased. The Valuation Date on which an Eligible Fund will be purchased, will in no event, be later than 2 business days after the date upon which a Deposit is received by the Company at its Administrative Offices. |

SECTION 1. DEFINITIONS (continued)

| | | |
|---|---|---|
| Valuation Period | - | the period between successive Valuation Dates. |
| Variable Contract Value | - | the sum of the values of the Variable Sub-Accounts credited to the Group Policyholder in respect of a Participant under a Participant Annuity Account. |
| Variable Sub-Account | - | a sub-division of an Investment Division which separates Deposits received under tax qualified arrangements from those received under non-tax qualified arrangements. Each Variable Sub-Account has its own Accumulation Unit and Annuity Unit Value. |
| Written Request | - | any request in written form, satisfactory to the Company and received by the Company at its Administrative Office, from the Group Policyholder, the Participant, or their designee as required by any provision of this Group Annuity Contract, if any, and at other times as required by the Company. A form or direction in lieu of the Written Request may be accepted by the Company in its sole discretion. |

## SECTION 2. OWNERSHIP PROVISIONS

### 2.1 Ownership of Series Account

The Company has absolute ownership of the assets of the Series Account.

### 2.2 Ownership of Group Annuity Contract

Upon the Group Policyholder's Application for this Group Annuity Contract, the Group Policyholder becomes the owner of the Group Annuity Contract. It alone has all rights, remedies and recourses given in the Group Annuity Contract, and, while the Group Annuity Contract and the Participant Annuity Accounts are held in respect of Participants, there is no contractual relationship between the Company and the Participants. While the Group Policyholder may request the opinion of the Participant on matters and transactions affecting the Participant Annuity Account, the Group Policyholder may act according to the dictates of its own judgment and discretion.

Subject to the Plan participation provisions, each employee for whom Deposits have been made is a Participant for whom a Participant Annuity Account is kept.

### 2.3 Transfer and Assignment

The interest of the Group Policyholder in this Group Annuity Contract may not be transferred, sold, assigned, pledged, charged, encumbered, or in any way alienated without the prior written consent of the Company.

## SECTION 3. GENERAL PROVISIONS

### 3.1 The Group Annuity Contract

The Group Annuity Contract is issued by the Company to the Group Policyholder.

### 3.2 Entire Contract

This Group Annuity Contract, its Application, Tables, Guaranteed Sub-Account Riders and /or Letter Agreements, if any, form the entire contract between the Group Policyholder and the Company. A copy of the Application is attached to the Group Annuity Contract when issued to the Group Policyholder.

After issue, modifications to the Group Annuity Contract under the Contract Modification provisions become part of the Group Annuity Contract.

All statements in the Application, in the absence of fraud, have been accepted as representations and not as warranties.

Only the President, a Vice-President, or the Secretary of the Company can modify or waive any provisions of the Group Annuity Contract.

### 3.3 The Plan

The terms and provisions of the Plan do not for any purpose form any part of this Group Annuity Contract and are not binding on the Company.

Notwithstanding the fact that the Company may have knowledge of the terms of the Plan, the obligations of the Company are measured and determined solely by the terms and provisions of this Group Annuity Contract.

### 3.4 Non-Participating

This Group Annuity Contract is non-participating, meaning that it is not eligible to share in the Company's divisible surplus.

### 3.5 Currency and Payment of Deposits

All amounts to be paid to or by the Company must be in the currency of the United States of America. All Deposits to this Group Annuity Contract must be made payable to the Company or its designated agent.

SECTION 3. GENERAL PROVISIONS (continued)

3.6 Age

If the age of the Participant or Payee has been misstated, the payments established for him/her under the Participant Annuity Account will be made on the basis of his/her correct age.

If payments were too large because of misstatement, the difference with interest may be deducted by the Company from the next payment or payments. If payments were too small, the difference with interest may be added by the Company to the next payment. This interest will be not less than 4% per year.

3.7 Voting Rights and Reports

The Company will vote the shares of an Eligible Fund held in a Variable Sub-Account of the Investment Division of the Series Account. To the extent required by law, the Company will vote according to the instructions of the Group Policyholder in proportion to its interest in the Variable Sub-Account. In such event, the Company will send proxy materials and form(s) to the Group Policyholder for its reply. If no reply is received, the Company will vote shares of the appropriate Eligible Fund in the same proportion as shares of the Eligible Fund for which replies have been received.

During the Annuity Payment Period under the Participant Annuity Account, the number of votes will decrease as the assets held to fund annuity payments decrease, the Payee will be entitled to receive the proxy materials and form(s) otherwise provided to the Gorup Policyholder, and all other provisions concerning Voting Rights will apply to the Payee of a Variable Dollar Method of Payment Option.

The Company will furnish the Group Policyholder or the Payee of a Variable Dollar Method of Payment Option copies of any shareholder reports of the Eligible Funds and of any other notices, reports or documents required by law to be furnished to either of them.

Semi-annual reports of the Eligible Funds will be furnished as required by law to the Group Policyholder, who shall promptly deliver them to each Participant or Payee of a Variable Dollar Method of Payment Option. The Company will furnish the Group Policyholder not less frequently than annually a statement of each Participant's Participant Annuity Account Value, which the Group Policyholder will promptly deliver to the Participant. The Group Policyholder may direct the Company to deliver these reports and statements to the Participants.

SECTION 3. GENERAL PROVISIONS (continued)

3.8 Notice and Proof

Any notice or demand by the Company to or upon the Group Policyholder or any Payee may be given by mailing it to that person's last known address as stated in the Company's file.

An application, report, request, election, direction, notice or demand by the Group Policyholder or Payee will be made in a form satisfactory to the Company. When the Company requires it, the Group Policyholder will obtain the signature of the Participant's or Payee's spouse on forms provided by the Company.

The Company may require adequate proof of the age and death of any Payee before it admits a claim for or pays any payment.

Written materials developed by the Group Policyholder to describe this Group Annuity Contract must first be approved by the Company.

## SECTION 4. PURCHASE PROVISIONS

### 4.1 Commencement and Termination of Coverage

The Group Policyholder may make application for coverage of any employee if the Company is then accepting applications for coverage under this Group Annuity Contract, unless a Date of Cessation of Deposits has been declared.

An employee for whom an adequate application has been made becomes covered as a Participant as of the Participant Effective Date. Coverage of a Participant terminates upon the Group Policyholder's total or partial distribution which results in a Participant Annuity Account Value of $0.

### 4.2 Deposits

Unless a Date of Cessation of Deposits has been declared, the Group Policyholder may from time to time pay Deposits in cash in respect of a Participant until the earlier of his/her death, Annuity Commencement Date, or the termination of the Participant Annuity Account.

The amount of Deposits to be paid by the Group Policyholder in respect of any Participant will be determined by the Group Policyholder.

The Group Policyholder will report the amount paid as Deposits on forms acceptable to the Company. The Group Policyholder's report is conclusive and binding on it and any person or entity claiming an interest under the Group Annuity Contract or any Participant Annuity Account. When the Group Policyholder's report does not coincide with the Deposits received, the Company may return them.

### 4.3 Allocation of Deposits

After an adequate application on behalf of a Participant has been made, Deposits, less Premium Tax, if any, will be allocated in the Participant Annuity Account when received by the Company at its Administrative Offices.

Deposits on behalf of the Participant will be allocated among any number of currently offered Variable and Guaranteed Sub-Accounts in accordance with the latest recorded Written Request of the Group Policyholder on behalf of the Participant.

The allocation of Deposits may be changed at any time upon the Company's receipt at its Administrative Offices of the Written Request of the Group Policyholder on behalf of the Participant. A change of allocation will be effective for Deposits which are received after the Company's receipt and recording of the change.

## SECTION 5. CONTRACT VALUE PROVISIONS

### 5.1 Variable Contract Value

The Variable Contract Value for a Participant on any date during the Accumulation Period will be the sum of the values of the Variable Sub-Accounts of the Series Account held for the Participant.

The value of a Participant's interest in a Variable Sub-Account will be determined by multiplying the number of Accumulation Units held for the Participant for that Variable Sub-Account by the Accumulation Unit Value for that Variable Sub-Account.

### 5.2 Accumulation Unit

Deposits received at the Administrative Offices of the Company before the close of a Valuation Period will be allocated as requested and applied as of that date based upon the Accumulation Unit Value for that Variable Sub-Account as of the Valuation Date immediately following receipt of the funds, to provide Accumulation Units of the selected Variable Sub-Accounts of the Series Account.

The number of Accumulation Units credited for each Participant to a Variable Sub-Account will be determined by dividing the amount of the Deposits then applied to such Variable Sub-Account by the Accumulation Unit Value for that Variable Sub-Account on the Valuation Date on which the Deposits were made and allocated.

The number of Accumulation Units will not change because of a later change in the Accumulation Unit Value, but the Accumulation Unit Value will vary to reflect the investment experience of the Variable Sub-Account.

### 5.3 Accumulation Unit Value

The Accumulation Unit Value of a Variable Sub-Account on any Valuation Date is equal to the Accumulation Unit Value of that Variable Sub-Account as of the immediately preceding Valuation Date multiplied by the net investment factor (as explained in Section 5.6) for the Valuation Period ending on the Valuation Date on which the Accumulation Unit Value is being determined.

The Accumulation Unit Value may increase, decrease, or remain unchanged as a result of the value of the net investment factor.

SECTION 5. CONTRACT VALUE PROVISIONS (continued)

5.4 Annuity Unit Value

The initial Annuity Unit Value of each Variable Sub-Account was established at $1 on the date a Deposit was first made under a Variable Annuity Method of Payment to the Variable Sub-Account(s).

The Annuity Unit Value of any Variable Sub-Account on any subsequent Valuation Date is equal to the Annuity Unit Value for the immediately preceding Valuation Date multiplied by the net investment factor for that Variable Sub-Account for the Valuation Period ending on the Valuation Date on which the Annuity Unit Value is being determined, and multiplying the result by a factor of .999905 to neutralize the assumed investment rate of 3.5% per year used in the applicable Table for Variable Dollar Method of Payment Options 1, 2, 3, and 4.

The Annuity Unit Value may increase, decrease or remain unchanged as a result of the value of the net investment factor.

5.5 Risk Charge

The Company will deduct the risk charge for expense and mortality guarantees in the calculation of the net investment factor. This charge is equal to 1.25% on an annual basis of the daily net asset value of each Variable Sub-Account. This deduction is made daily.

5.6 Net Investment Factor

The net investment factor for any Variable Sub-Account for any Valuation Period is determined by dividing (A) by (B), and subtracting (C) from the result where:

(A) is the net result of:

(1) the net asset value per share of the Eligible Fund shares held in the Variable Sub-Account determined as of the end of the current Valuation Period, plus

(2) the per share amount of any dividend (or, if applicable, capital gain distributions) made by the Eligible Fund on shares held in the Variable Sub-Account if the "ex-dividend" date (the date four days before the record date which determines if the Group Policyholder is eligible to receive a dividend) occurs during the current Valuation Period, minus or plus

(3) a per unit charge or credit for any taxes incurred by or reserved for in the Variable Sub-Account, which is determined by the Company to have resulted from the investment operations of the Variable Sub-Account.

5.6 Net Investment Factor (continued)

(B) is the net result of:

(1) the net asset value per share of the Eligible Fund shares held in the Variable Sub-Account determined as of the end of the immediately preceding Valuation Period, minus or plus,

(2) the per unit charge or credit for any taxes incurred by or reserved for in the Variable Sub-Account for the immediately preceding Valuation Period.

(C) is a factor representing the risk charge.

The net investment factor may be greater than, less than, or equal to one. Therefore, the Accumulation Unit Value and the Annuity Unit Value may increase, decrease or remain unchanged.

The per share amount of any dividend referred to in paragraph (A)(2) includes a deduction for an investment advisory fee. This fee compensates the investment adviser for services provided to the Eligible Fund. The fee may differ between Eligible Funds and may be renegotiated each year, but will never exceed an annual rate of 1.00% of the aggregate average daily net assets of the Eligible Fund.

5.7 Guaranteed Contract Value

The Guaranteed Contract Value of a Participant Annuity Account on any date during the Accumulation Period will be the sum of the values of the Guaranteed Sub-Accounts credited to such Participant Annuity Account.

The Company may offer one or more Guaranteed Sub-Accounts into which Deposits will be made at the Written Request of the Group Policyholder on behalf of the Participant.

5.8 Guaranteed Sub-Account Riders

The computation of the value of a Guaranteed Sub-Account is described in greater detail in the attached Guaranteed Sub-Account Riders, if any.

## 5.9 Contract Maintenance Charge

On the first day of each calendar year a contract maintenance charge of not more than $60 annually will be declared by the Company and deducted from the Participant Annuity Account. If a Participant Annuity Account is established for a Participant after that date, the contract maintenance charge will be deducted on the first day of the next quarter and will be pro-rated for the year remaining. No refund of this charge will be made.

The deduction will be pro-rated among the Variable and Guaranteed Sub-Accounts based upon their Variable and Guaranteed Contract Values on the date of deduction. Whenever a deduction for a contract maintenance charge is to be made from a Variable Sub-Account, the Company will cancel Accumulation Units having a total value equal to the amount of the deduction. The Group Policyholder may elect to pay such expenses to the Company separately. If such an election has been made, then no charge will be made against the Variable and Guaranteed Sub-Accounts unless payment is not received within 30 days.

## SECTION 6. TRANSFERS

### 6.1 Transfers

The Group Policyholder may make Intra-Company Transfers, Plan-to-Plan Transfers or Transfers to Other Companies by Written Request on behalf of the Participant.

### 6.2 Transfer Terms

a. A transfer will take effect on the later of the date elected or the date the Written Request is received at the Administrative Offices of the Company. If such Written Request is received after 4:00 p.m. EST/EDT, the transfer will take effect on the later of the date elected or the date following the date the Written Request is received and a unit value is calculated.

b. A telephone transfer, if permitted, will take effect on the later of the date elected or the date the telephone call is received at the Administrative Office. If such call is received after 4:00 p.m. EST/EDT, the transfer will take effect on the later of the date elected or the date following the date the call is received and a unit value is calculated.

c. When the Company requires it, the Group Policyholder on behalf of the Participant will execute forms provided by the Company as necessary to the requested transfer.

d. No transfers are permitted after the Annuity Commencement Date.

e. No transfers from the Guaranteed Certificate Fund may be made prior to the Certificate Maturity Date, as defined in the Guaranteed Certificate Fund Rider, if any. The amount available for transfer is the value of that Certificate on its Maturity Date. The Group Policyholder's Written Request to transfer must be received by the Company within 30 days after the Certificate Maturity Date.

### 6.3 Intra-Company Transfers

a. At any time prior to the Annuity Commencement Date, the Group Policyholder on behalf of the Participant may by Written Request transfer all or a portion of the Participant Annuity Account Value within and between the Variable and Guaranteed Sub-Accounts currently offered by the Plan.

b. At any time prior to the Annuity Commencement Date, the Group Policyholder on behalf of the Participant may by Written Request make an Intra-Company Plan-to-Plan Transfer.

SECTION 6. TRANSFERS (continued)

6.3 Intra-Company Transfers (Continued)

c. If an Intra-Company Transfer is made within 30 days of the Annuity Commencement Date, the Company may delay the Annuity Commencement Date by 30 days.

d. If a Participant dies prior to the Annuity Commencement Date, one Intra-Company Transfer may be made after the death of the Participant by the Group Policyholder on behalf of the Payee to effect the election of a Payment Option.

e. No Contingent Deferred Sales Charge will apply to Intra-Company Transfers.

6.4 Transfers to Other Companies

a. At any time prior to the Annuity Commencement Date, the Group Policyholder on behalf of the Participant may by Written Request transfer all or a portion of the Participant Annuity Account Value to an account currently offered by another company under the terms of the Plan.

b. At any time prior to the Annuity Commencement Date, the Group Policyholder on behalf of the Participant may by Written Request transfer the entire Participant Annuity Account Value to an account offered by another company under another eligible deferred compensation plan.

c. The Contingent Deferred Sales Charge described in Section 9 shall apply to any and all Transfers to Other Companies.

6.5 Plan-to-Plan Transfers

a. Plan-to-Plan Transfers where the amounts remain with the Company under a new eligible deferred compensation plan shall be treated as Intra-Company Transfers.

b. Plan-to-Plan Transfers where the amounts are transferred to other companies under a new eligible deferred compensation plan shall be treated as Transfers to Other Companies.

6.6 Transfers To The Company

Amounts transferred to the Company shall be treated as Deposits under Section 4 of this Contract.

6.7 Non-Taxable Distribution

No amount transferred pursuant to these provisions will be treated as a taxable distribution to the Participant.

## SECTION 7. <u>DISTRIBUTIONS TO A BENEFICIARY</u>

7.1 <u>Death of Participant after Annuity Commencement Date.</u>

If the Participant dies after the Annuity Commencement Date and before his/her entire interest has been distributed, payments will continue to the Beneficiary under the Payment Option applicable to the Participant on the Participant's date of death. Notwithstanding the preceding sentence, if the Plan allows the Beneficiary to change the method of distribution, a new Payment Option may be elected by Written Request by the Group Policyholder on behalf of the Beneficiary only so long as payments are made to the Beneficiary not less rapidly than under the Payment Option effective on the Participant's date of death. The Contingent Deferred Sales Charge will not apply.

7.2 <u>Death of Participant before Annuity Commencement Date.</u>

a. <u>5-Year Rule</u>. If the Participant dies before the Annuity Commencement Date, the entire interest of the Participant must be distributed within five years after the death of the Participant. This Rule will always apply to non-individual entities.

b. <u>1-Year Rule</u>. If the Plan provides that any portion of the Participant's interest is payable to a designated Beneficiary, such portion may be distributed over the lesser of (1) the life of the designated Beneficiary, or (2) over a period not extending beyond the life expectancy of the designated Beneficiary or (3) 15 years. Such distributions to a designated Beneficiary must begin not later than December 31 of the year following the date of the Participant's death. The Group Policyholder on behalf of the designated Beneficiary may elect by Written Request to take distributions either under the 5-Year Rule or under this 1-Year Rule. If no election is received by the Company by November 1 of the year following the year of the Participant's death, distributions will be made pursuant to the 5-Year Rule described in subsection a. of Section 7.2.

For purposes of this section, a designated Beneficiary is any individual named as a Beneficiary by the Participant.

c. <u>Special Rule for Surviving Spouse</u>. If the designated Beneficiary is the surviving spouse of the Participant, the date on which the distributions are required to begin shall not be earlier than the date on which the Participant would have attained age 70 1/2. Distributions may be elected at any time pursuant to Section 10 of this Contract; but in any event must commence on or before the later of (1) December 31 of the year immediately following the Participant's death and (2) December 31 of the calendar year in which the Participant would have attained age 70 1/2.

7.2 Death of Participant before Annuity Commencement Date. (continued)

d. Any payments made over a period greater than one year can only be made in substantially non-increasing amounts paid not less frequently than annually.

e. The Contingent Deferred Sales Charge will not apply.

7.3 Amount Payable on Death of Participant

If the Participant dies before the Annuity Commencement Date the Amount Payable on Death will be:

(a) Where death occurs before the Participant's 70th birthday, the greater of:

(i) the Participant Annuity Account Value, less Premium Tax, if any, and

(ii) the sum of Deposits paid to, less any Partial Distributions made from, the Participant Annuity Account, less Premium Tax, if any.

(b) Where death occurs on or after the Participant's 70th birthday, the Participant Annuity Account Value, less Premium Tax, if any.

7.4 Requests For Distributions

Subject to the 5-Year rule, the 1-Year rule or the Special Rule for Surviving Spouse, as applicable, set forth in Section 7.2, an election to receive the amount described in Section 7.3 must be made pursuant to Section 10 of this Contract.

## SECTION 8. DISTRIBUTIONS TO A PARTICIPANT

### 8.1 Requests for Distributions

On the Company's receipt of the Written Request at least 30 days before the Annuity Commencement Date, the Group Policyholder on behalf of the Participant may:

a. Elect or change a Payment Option.

b. Elect or change the Participant's Annuity Commencement Date to any future date which is not later than April 1 of the calendar year following the calendar year in which the Participant attains the later of age 70 1/2 or separation from service. If any Annuity Commencement Date would be less than 30 days from the date the Written Request is received, the Company may delay the Annuity Commencement Date elected by 30 days.

c. If the Group Policyholder on behalf of the Participant has failed to elect a Payment Option within 30 days of the Annuity Commencement Date, the Company will pay the Group Policyholder on behalf of the Participant a Variable Life Annuity with 10 Year Guaranteed Period from the Variable Contract Value and a Fixed Life Annuity with 10 Year Guaranteed Period from the Guaranteed Contract Value.

### 8.2 Distribution at age 70 1/2 or Separation From Service

Except as provided in Section 8.3, no distributions will be allowed prior to the Participant's attainment of age 70 1/2, or separation from service, as determined by the Group Policyholder. The distribution must be elected pursuant to Section 10 of this Contract and will take effect on the later of the date elected and the date the Written Request is received at the Administrative Offices of the Company.

### 8.3 Distribution Due to Unforeseeable Emergency

If the Participant incurs an unforeseeable emergency as determined by the Group Policyholder under the terms of the Plan, then the Group Policyholder on behalf of the Participant may by Written Request take a total or partial distribution from the Participant Annuity Account. The distribution will take effect on the later of the date elected and the date the Written Request is received at the Administrative Offices of the Company.

8.4 Amount Payable on Distribution

If a total distribution is requested, the amount payable will be paid under the Payment Option provisions of Section 10 designated by the Group Policyholder on behalf of the Participant. If a partial distribution is requested, the amount payable will be in one sum. In either event, the amount will be equal to:

(a) The amount of the distribution requested as of the effective date of the distribution, less

(b) the Contingent Deferred Sales Charge, if any, less

(c) Premium Tax, if any.

8.5 Conditions of Payment

Payment will only be made if then available to the Payee under the terms and provisions of the Plan as determined by the Group Policyholder, and will only be made to the Group Policyholder or to the order of the person designated in Written Request by the Group Policyholder to receive payment.

8.6 Adequate Proof

The Company may require adequate proof of age, separation from service or unforeseeable emergency to establish that a benefit has become payable under the provisions of the Plan prior to making any payment under this Group Annuity Contract.

## SECTION 9. CONTINGENT DEFERRED SALES CHARGE

### 9.1 Transfers

On any total or partial transfer of the Participant Annuity Account to another company, the Contingent Deferred Sales Charge will be deducted from the amount transferred. The Contingent Deferred Sales Charge will be equal to a percentage of the amount transferred based on the table in 9.2 below.

### 9.2 Lump Sum Distributions

On any total or partial lump sum distribution of the Participant Annuity Account at age 70 1/2, separation from service or due to an unforeseeable emergency, a Contingent Deferred Sales Charge will be deducted from the amount distributed. The Contingent Deferred Sales Charge will be equal to a percentage of the amount distributed in excess of the Contingent Deferred Sales Charge Free Amount, if any, based on the table below.

Contingent Deferred Sales Charge Table

| Completed Years From Participant Effective Date Under this Contract | % of Amount Transferred or Distributed |
|---|---|
| 0 - 4 | 5% |
| 5 - 9 | 4% |
| 10 - 14 | 3% |
| 15 or more | 0% |

Notwithstanding anything in this Group Annuity Contract to the contrary, in no event shall the Contingent Deferred Sales Charge at any point in time exceed 8.5% of Deposits contributed by the Participant into this Group Annuity Contract.

### 9.3 Contingent Deferred Sales Charge "Free Amount"

The Contingent Deferred Sales Charge "Free Amount" applicable to any total or partial lump sum distributions is equal to 10% of the Participant Annuity Account Value at December 31 of the calendar year prior to the year in which the amount is distributed.

Only one Contingent Deferred Sales Charge "Free Amount" is available on behalf of a Participant in each calendar year. The Contingent Deferred Sales Charge "Free Amount" will be applied on the first distribution made under the Participant Annuity Account in that year.

## SECTION 10. PAYMENT OPTIONS

### 10.1 Selection of Payment Options

(a) A total or partial lump sum or one of the variable or fixed dollar payment options or a combination of them may be elected.

(b) If the Group Policyholder on behalf of the Payee elects to apply any or all of the Guaranteed Contract Value to a variable dollar method of payment option, or any or all of the Variable Contract Value to a fixed dollar method of payment option, an Intra-Company Transfer must be made prior to the Annuity Commencement Date pursuant to Section 6.

(c) If a lump sum option is elected, the amount to be distributed is the amount requested as a lump sum less the Contingent Deferred Sales Charge, if any, and Premium Tax, if any, as of the date the amount is distributed.

(d) If a variable dollar payment option is elected, the amount to be applied is the Variable Contract Value, less Premium Tax, if any, as of the date the amount of the first monthly payment is determined.

(d) If a fixed dollar method of payment option is elected, the amount to be applied is the Guaranteed Contract Value, less Premium Tax, if any, as of the Annuity Commencement Date.

### 10.2 How to Elect Payment Options

The Written Request of the Group Policyholder on behalf of the Participant or Payee is required to elect, or change the election of, a Payment Option and must be received by the Company at least 30 days prior to the Annuity Commencement Date, or, if the Participant dies prior to the Annuity Commencement Date, within 60 days of the date the Company receives adequate proof of the Participant's death.

The Company will rely on the Group Policyholder's determination with respect to the timing and amount of any benefit payable to the Participant or Payee under this Contract. Nothing contained herein shall be construed to be tax or legal advice and the Company assumes no responsibility or liability for any costs, including but not limited to taxes, penalties or interest incurred by the Plan, the Group Policyholder, the Participant or any Payee arising out of such determination.

SECTION 10. PAYMENT OPTIONS (continued)

10.3 Variable Dollar Payment Options

The following variable dollar payment options are available:

(a) Option 1: Variable Life Annuity with Guaranteed Period

The Company will pay a monthly payment for the guaranteed Annuity Payment Period elected. Payments will continue for the lifetime of the Payee. The guaranteed Annuity Payment Period elected may be 5, 10, 15, or 20 years. Upon death of the Payee, any amounts remaining payable under this payment option will be paid to the Group Policyholder or other Payee designated by the Group Policyholder under Section 7 of this Group Annuity Contract.

(b) Option 2: Variable Life Annuity

The Company will pay a monthly payment during the Payee's lifetime. Table A is applicable to this Payment Option.

(c) Option 3: Joint and One-Half Survivor Variable Annuity

A joint and one-half survivor variable annuity provides a variable monthly payment to an Annuitant for his/her lifetime; thereafter, and upon receipt by the Company of adequate proof of the Annuitant's death, one-half of the variable payment amount continues to a designated Payee, if living, and terminates upon his/her death. Table B is applicable to this Option.

(d) Option 4: Any Other Form

The Company will pay any other form of Variable Annuity which is acceptable to it. Upon death of the Payee, any amounts remaining under this Payment Option will be paid to the Group Policyholder or other Payee designated by the Group Policyholder under Section 7 of this Group Annuity Contract.

(e) These variable dollar payment pptions are subject to the following provisions:

(1) Amount of First Monthly Payment. The first monthly payment under a variable dollar payment option will be based on the Variable Contract Value credited on behalf of the Participant Annuity Account on the 5th Valuation Date preceding the Annuity Commencement Date. It will be determined by applying the appropriate rate from the applicable Table to the amount applied under the payment option. The first monthly payment will be the sum of the variable dollar annuity payments for each Variable Sub-Account.

SECTION 10. PAYMENT OPTIONS (continued)

10.3 Variable Dollar Payment Options (continued)

(2) Annuity Units. The number of Annuity Units for each Variable Sub-Account to be credited in respect of the Participant Annuity Account will be determined by dividing the portion of the first monthly payment to be taken from such Sub-Account by the Sub-Account's Annuity Unit Value on the 5th Valuation Date preceding the date the first payment is due for which the number of Annuity Units is being computed. The number of Annuity Units for a Variable Sub-Account remains fixed during the Annuity Payment Period.

(3) Amount of Monthly Payments after the First. Monthly payments after the first will vary in amount from time to time depending upon the investment experience of the Variable Sub-Accounts of the Series Account. The dollar amount of each Variable Dollar Annuity payment to the Participant or Payee after the first for each Variable Sub-Account is determined by multiplying (a) the number of Sub-Account Annuity Units credited to the Participant Annuity Account by (b) the Sub-Account Annuity Unit Value on the 5th Valuation Date preceding the date the annuity payment is due. The total dollar amount of each variable dollar annuity payment will be the sum of the variable dollar annuity payments for each Variable Sub-Account. The Company guarantees that the dollar amount of each payment after the first will not be affected by variations in expenses or mortality experience.

(f) If any payment to be made under the elected payment option will be less than $50, the Company may make the payments in the most frequent interval which produces a payment of at least $50. The minimum amount that may be applied under the elected payment option is $2,000. If the amount is less than $2,000, the Company may pay it in one sum. The maximum amount that may be applied under any elected payment option is $1,000,000. For the application of any greater amount, the Company's consent is required.

10.4 Fixed Dollar Payment Options

The following fixed dollar payment options are available:

10.4 Fixed Dollar Payment Options (continued)

(a) Option 1: Income of Specified Amount

The Company will pay an income at 12-, 6-, 3-, or 1-month intervals, of an amount elected by the Payee for an Annuity Payment Period of not less than 36 months nor more than 240 months. Upon death of the Payee, any amounts remaining payable under this payment option will be paid to the Group Policyholder or other Payee designated by the Group Policyholder under Section 7 of this Group Annuity Contract.

(b) Option 2: Income for a Specified Period

The Company will pay an income at 12-, 6-, 3-, or 1-month intervals, for the number of years elected by the Payee for an Annuity Payment Period of not less than 36 months nor more than 240 months. Upon death of the Payee, any amounts remaining payable under this payment option will be paid to the Group Policyholder or other Payee designated by the Group Policyholder under Section 7 of this Group Annuity Contract. Table C is applicable to this Option.

(c) Option 3: Fixed Life Annuity with Guaranteed Period

The Company will pay a monthly payment for the guaranteed Annuity Payment Period elected. Payments will continue for the lifetime of the Payee. Upon death of the Payee, any amounts remaining payable under this payment option will be paid to the Group Policyholder or other Payee designated by the Group Policyholder under Section 7 of this Group Annuity Contract. Table D is applicable to this option.

The guaranteed Annuity Payment Period elected may be 5, 10, 15 or 20 years, or may be a period referred to as "Installment Refund". Under the Installment Refund period, payments will be made until the total of the payments made equals the amount applied.

(d) Option 4: Fixed Life Annuity

The Company will pay a monthly payment during the Payee's lifetime. Table D is applicable to this option.

SECTION 10. PAYMENT OPTIONS (continued)

10.4 Fixed Dollar Payment Options (continued)

(e) Option 5: Joint and One-Half Survivor Fixed Annuity

A joint and one-half survivor fixed annuity provides a fixed monthly payment to an Annuitant for his/her lifetime; thereafter, and upon receipt by the Company of adequate proof of the Annuitant's death, one-half of the fixed payment amount continues to a designated Payee, if living, and terminates upon his/her death. Table E is applicable to this option.

(f) Option 6: Systematic Withdrawal Option

The Company will pay a monthly, quarterly, semi-annual or annual payment to the Payee as elected by Written Request by the Group Policyholder on behalf of the Payee. The amount, timing and method of payment will be as elected by the Group Policyholder on behalf of the Payee and agreed to by the Company. The details and provisions of the Systematic Withdrawal Option are described in greater detail in the attached Systematic Withdrawal Option Rider, which is hereby made a part of this Group Annuity Contract.

(g) Option 7: Any Other Form

The Company will pay any other form of Fixed Annuity which is acceptable to it. Upon death of the Payee, any amounts remaining payable under this payment option will be paid to the Group Policyholder or other Payee designated by the Group Policyholder under Section 7 of this Group Annuity Contract.

(h) These fixed dollar payment options are subject to the following provisions:

(1) Payments under a fixed dollar payment option are guaranteed by the Company as to dollar amount throughout the Annuity Payment Period.

The amount of the payment under any fixed dollar payment option will be determined by applying the Company's then current non-participating group single premium rates for this class of group annuity contracts to the amount applied under the option. Those current rates will not be less than the rate obtained from the Table which is applicable to the elected option.

SECTION 10. PAYMENT OPTIONS (continued)

10.4 Fixed Dollar Payment Options (continued)

(2) If any payment to be made under the elected payment option will be less than $50, the Company may make the payments in the most frequent interval which produces a payment of at least $50. The minimum amount that may be applied under the elected payment option is $2,000. If the amount is less than $2,000, the Company may pay it in one sum. The maximum amount that may be applied under any elected payment option is $1,000,000. For the application of any greater amount, the Company's consent is required.

## SECTION 11. CONTRACT MODIFICATION

### 11.1 Contract Modification

This Group Annuity Contract may be modified at any time by written agreement between the Company and the Group Policyholder. No such modification will, without the written consent of the Group Policyholder, affect the terms, provisions, or conditions of this Group Annuity Contract which are or may be applicable to Deposits paid in respect of Participants prior to the date of such modification.

However, the Company may at any time and without the consent of the Group Policyholder or any Participant or other person, but upon 30 days' written notice to the Group Policyholder, modify this Group Annuity Contract in any respect to conform it to changes in tax or other law, including applicable regulations or rulings.

### 11.2 Modification of Tables

The Company may at any time and without the consent of the Group Policyholder or any Participant or other person, but upon 30 days' written notice to the Group Policyholder, modify Tables A, B, C, D, and E, or any of them. However, no such modification will affect the terms, provisions or conditions of the Group Annuity contract which are or may be applicable to Deposits paid in respect of Participants prior to the date of such modification.

### 11.3 Modification of Guaranteed Sub-Account Riders, if Any

Any Guaranteed Sub-Account Rider may be modified at any time by written agreement between the Company and the Group Policyholder. No such modification will, without the written consent of the Group Policyholder, affect the terms, provisions, or conditions of the Rider which are or may be applicable to Deposits paid in respect of Participants prior to the date of such modification.

### 11.4 Modification of Variable and/or Guaranteed Sub-Account Riders, If Any

Notwithstanding the other contract modification provisions, the Company may offer new or cease offering existing Variable or Guaranteed Sub-Accounts. No such modification shall affect the terms, provisions, or conditions which are or may be applicable to Deposits previously paid to any Variable or Guaranteed Sub-Account which is no longer offered by the Company. The Company will periodically notify the Group Policyholder on behalf of the Participants of the current offering of Variable or Guaranteed Sub-Accounts.

## SECTION 12. CESSATION OF DEPOSITS

### 12.1 Cessation of Deposits

Upon 60 days' written notice to the other, the Group Policyholder or the Company may declare that, as from the date stated in the notice (that date being called a Date of Cessation of Deposits), no further Deposits will be made to certain or all Guaranteed Sub-Accounts of the Group Annuity Contract.

If a Date of Cessation of Deposits has been declared for certain Sub-Accounts, the Group Policyholder in respect of the Participant may by Written Request make a change of allocation of his/her new Deposits. When no change of allocations is received, the Company may return all new Deposits affected by the declaration of the Date of Cessation of Deposits, or allocate such new Deposits to a currently offered Guaranteed Sub-Account.

After the Date of Cessation of Deposits declared in respect of all Sub-Accounts, no new Participant Annuity Account will be established.

### 12.2 Options on Date of Cessation of Deposits

Upon the Date of Cessation of Deposits for all Sub-Accounts, the Group Policyholder may by Written Request elect one of the following cessation options. If the Group Policyholder has not elected a cessation option within 30 days of the Date of Cessation, the Company will make the election in its sole discretion. Such election shall be binding on the Group Policyholder.

a. Cessation Option (1) Maintenance of Each Participant Annuity Account Value:

The Company will maintain each Participant Annuity Account Value until it is applied to a Payment Option or paid under the Group Annuity Contract.

b. Cessation Option (2) Installment Settlement of Contract Values:

Upon receipt of a Written Request from the Group Policyholder and subject to the provisions relating to Transfers to Other Companies, the Company will pay the sum of the Variable Contract Values in respect of Participants as of the Date of Cessation of Deposits to the successor insurer of the Plan or to the Group Policyholder within 7 days of the date the cessation option is elected.

Upon receipt of a Written Request from the Group Policyholder, the Company will pay the sum of the Guaranteed Contract Values in respect of the Participants as of the Date of Cessation of Deposits to the successor insurer of the Plan or to the Group Policyholder in 20 equal quarterly installments. The amount of the installments will be the amount determined by the Company on the date of the first such payment, but not less than $514.80 for each $10,000 of Guaranteed Contract Values. The first payment will be made 30 days after the date the cessation option is elected.

TABLE A - Variable Life Annuity

Monthly Payment for Each $1,000
of Participant Annuity Account Value

| Age of Payee | Without Guaranteed Period | With Guaranteed Period | | | |
|---|---|---|---|---|---|
| | | 5 Years | 10 Years | 15 Years | 20 Years |
| 50 | 3.99 | 3.99 | 3.98 | 3.96 | 3.94 |
| 55 | 4.31 | 4.30 | 4.27 | 4.24 | 4.19 |
| 60 | 4.71 | 4.70 | 4.67 | 4.60 | 4.49 |
| 65 | 5.28 | 5.25 | 5.18 | 5.05 | 4.84 |
| 70 | 6.07 | 6.02 | 5.85 | 5.56 | 5.15 |
| 75 | 7.22 | 7.09 | 6.68 | 6.07 | 5.41 |

If payments commence on any other date than the exact age of the Payee as shown above, the amount of the monthly payment shall be determined by the Company on the actuarial basis used by it in determining the above amounts.

TABLE B - Joint and One-Half Survivor Variable Annuity

Monthly Payment for Each $1,000
of Participant Annuity Account Value

| Age of Annuitant | If Designated Payee Is Age | | | | | |
|---|---|---|---|---|---|---|
| | 50 | 55 | 60 | 65 | 70 | 75 |
| 50 | 3.88 | 3.91 | 3.94 | 3.96 | 3.97 | 3.98 |
| 55 | 4.09 | 4.15 | 4.19 | 4.23 | 4.25 | 4.27 |
| 60 | 4.34 | 4.43 | 4.51 | 4.58 | 4.63 | 4.66 |
| 65 | 4.64 | 4.77 | 4.90 | 5.01 | 5.10 | 5.16 |
| 70 | 4.99 | 5.17 | 5.36 | 5.55 | 5.70 | 5.83 |
| 75 | 5.40 | 5.65 | 5.91 | 6.19 | 6.46 | 6.69 |

If payments commence on any other date than the exact age of the Annuitant or designated Payee as shown above, the amount of the monthly payment shall be determined by the Company on the actuarial basis used by it in determining the above amounts.

TABLE C - Income of Specified Amount
- Income of a Specified Period

Monthly Payment for Each $1,000
of Participant Annuity Account Value

| Years | Payment |
|---|---|
| 3 | 28.61 |
| 4 | 21.82 |
| 5 | 17.75 |
| 6 | 15.04 |
| 7 | 13.10 |
| 8 | 11.66 |
| 9 | 10.54 |
| 10 | 9.63 |
| 11 | 8.90 |
| 12 | 8.30 |
| 13 | 7.78 |
| 14 | 7.34 |
| 15 | 6.96 |
| 16 | 6.63 |
| 17 | 6.34 |
| 18 | 6.08 |
| 19 | 5.85 |
| 20 | 5.64 |

To determine the payment for other frequencies of payment, multiply the above monthly payment by the following factors:

| | Factor |
|---|---|
| Quarterly payment | 2.99 |
| Semi-annual payment | 5.96 |
| Annual payment | 11.81 |

If payments are for an amount or duration different than that outlined above, the Company will determine the proper amount or duration using the actuarial basis used to determine the above Table.

## TABLE D - Fixed Life Annuity

Monthly Payment for Each $1,000
of Participant Annuity Account Value

| Age of Payee | Without Guaranteed Period | With Guaranteed Period | | | |
|---|---|---|---|---|---|
| | | 5 Years | 10 Years | 15 Years | 20 Years |
| 50 | 3.99 | 3.99 | 3.98 | 3.96 | 3.94 |
| 55 | 4.31 | 4.30 | 4.27 | 4.24 | 4.19 |
| 60 | 4.71 | 4.70 | 4.67 | 4.60 | 4.49 |
| 65 | 5.28 | 5.25 | 5.18 | 5.05 | 4.84 |
| 70 | 6.07 | 6.02 | 5.85 | 5.56 | 5.15 |
| 75 | 7.22 | 7.09 | 6.68 | 6.07 | 5.41 |

If payments commence on any other date than the exact age of the Payee as shown above, the amount of the monthly payment shall be determined by the Company on the actuarial basis used by it in determining the above amounts.

TABLE E - Joint and One-Half Survivor Fixed Annuity

Monthly Payment for Each $1,000
of Participant Annuity Account Value

| Age of Annuitant | If Designated Payee Is Age 50 | 55 | 60 | 65 | 70 | 75 |
|---|---|---|---|---|---|---|
| 50 | 3.88 | 3.91 | 3.94 | 3.96 | 3.97 | 3.98 |
| 55 | 4.09 | 4.15 | 4.19 | 4.23 | 4.25 | 4.27 |
| 60 | 4.34 | 4.43 | 4.51 | 4.58 | 4.63 | 4.66 |
| 65 | 4.64 | 4.77 | 4.90 | 5.01 | 5.10 | 5.16 |
| 70 | 4.99 | 5.17 | 5.36 | 5.55 | 5.70 | 5.83 |
| 75 | 5.40 | 5.65 | 5.91 | 6.19 | 6.46 | 6.69 |

If payments commence on any other date than the exact age of the Annuitant or designated Payee as shown above, the amount of the monthly payment shall be determined by the Company on the actuarial basis used by it in determining the above amounts.

# GUARANTEED CERTIFICATE FUND RIDER

GUARANTEED SUB-ACCOUNT RIDER ATTACHED TO AND FORMING PART OF THE GROUP ANNUITY CONTRACT

The Guaranteed Certificate Fund is a Guaranteed Sub-Account, whereby Credited Interest Rates, not less than the rate noted below, are credited to Deposits held for varying Interest Guarantee Periods. The Company may offer Certificates to the Group Policyholder who may by Written Request allocate any Deposit in respect of the Participant to any one Certificate. The Group Policyholder in respect of the Participant may allocate Deposits only to those Certificates currently being offered by the Company.

If the Group Policyholder in respect of the Participant allocates Deposits to Certificates not currently offered by the Company, the Company may return such Deposits, allocate such Deposits to a currently offered Certificate, or allocate such Deposits to another currently offered Guaranteed Sub-Account.

**Definitions**

*"Certificate"* - represents the amount deposited into the Guaranteed Fund under each Interest Guarantee Period. Each Certificate has its own interest rate and Term.

*"Term"* - the duration of the Certificate which begins on the first day of the calendar quarter following the date of the Deposit and ends on the date specified by the Company. The duration of Terms available may be limited by the Company.

*"Certificate Maturity Date"* - the last day of the Term.

*"Interest Guarantee Period"* - the period from the date of the Deposit to the Certificate Maturity Date.

**Interest Crediting And Selection Of Payment Option**

Notwithstanding any other provision in the Group Annuity Contract to the contrary, the Credited Interest Rate on an annual effective basis will not be less than 0% and will be compounded daily. A Deposit to the Guaranteed Certificate Fund which remains in the Guaranteed Certificate Fund until the Certificate Maturity Date will earn a Credited Interest Rate for the Certificate's Interest Guarantee Period.

If the Participant dies, separates from service or has an unforeseeable emergency as determined by the Group Policyholder, amounts deposited into the Guaranteed Certificate Fund may be applied to a payment option prior to the Certificate Maturity Date. Amounts applied to a payment option pursuant to Section 10 of the Group Annuity Contract prior to the Certificate Maturity Date will receive the Credited Interest Rate from the date of deposit to the date the amount is applied to the elected payment option.

If the Participant has not died, separated from service or experienced an unforeseeable emergency as determined by the Group Policyholder, amounts deposited into the Guaranteed Certificate Fund must remain in the Certificate until the Certificate Maturity Date. Thus, no payment option may be elected, and no distributions or transfers will be permitted prior to the Maturity Date of each respective Certificate.

**Certificate Maturity**

Prior to the Certificate Maturity Date, the Company will offer a Guaranteed Sub-Account into which the value of the Certificate will be deposited on its Maturity Date. The Guaranteed Sub-Account so offered may be either the Guaranteed Certificate Fund or another Guaranteed Sub-Account.

If the Guaranteed Certificate Fund is offered, the value of the Certificate on its Maturity Date will establish a new Certificate which has its own Credited Interest Rate and Term. The Credited Interest Rate of this new Certificate may be higher or lower than the Credited Interest Rate of any other Certificate or Deposit.

If another Guaranteed Sub-Account is offered, the value of the Certificate on its Maturity Date will be deposited into that Guaranteed Sub-Account. The Credited Interest Rate of this Deposit may be higher or lower than the Credited Interest Rate of any other Deposit.

**Transfers**

- The terms of Section 6 of the Group Annuity Contract will apply to any transfer to or from the Guaranteed Certificate Fund.

**Value Of Guaranteed Certificate Fund**

The value of the Guaranteed Certificate Fund in respect of the Participant will be determined by adding his/her Guaranteed Certificate Fund Sub-Account's Deposits and interest, and subtracting his/her total or partial distributions, distributions to a Beneficiary, amounts distributed or applied under a payment option, transfers, Contract Maintenance Charge, and Premium Tax.

*Signed for Great-West Life & Annuity Insurance Company on the Issue Date of the Policy (unless a different date is shown here).*

W.T. McCallum,
President and Chief Executive Officer

This Rider, unless and until modified, forms part of the Group Annuity Contract.

## Letter Agreement

### Attached to and Forming Part of The Group Deferred Compensation Annuity Contract

It is agreed to by the Great-West Life & Annuity Insurance Company (herein called the "Insurance Company") and the State Board of Investment (herein called SBI or Group Policyholder) and Minnesota State Retirement System (herein called MSRS or Group Policyholder) on behalf of the State of Minnesota and all employers participating in the State of Minnesota Deferred Compensation Plan, agree that the following modifications and clarifications of the Group Annuity Contract, group policy number 88300-01, issued by the Insurance Company shall remain in effect for the period of time noted herein. Group Policy 88300-01, along with this Letter Agreement, supersede and replace any other previous Contracts, Agreements, Riders or representation(s).

1.) For the term of this Letter Agreement, the Contract Maintenance Charge, any other fees, charges, or Contingent Deferred Sales Charges referred to in the Group Policy #88300 are hereby waived for the term of the contract, with the exception of the Risk Charge of 1.25% described in Section 5.5 of the contract. The Risk Charge of 1.25% will be reduced to .95% effective September 1, 1994 for the term of the Letter Agreement.

2.) This Letter Agreement will be effective beginning September 1, 1994 and will terminate on June 30, 1999, unless terminated earlier pursuant to its terms. Upon termination of this Letter Agreement, Insurance Company may increase the Risk Charges and Investment Management Fees waived or reduced hereunder, and reduce interest rates on existing certificates as necessary, given the Insurance Company is obligated to pay an asset based marketing fee. Insurance Company may only reduce interest rates on existing certificates if the Group Policyholder increases the combined .40% asset based marketing and administration fees.

The Insurance Company agrees that the Guaranteed Contract Value Portability, the Variable Contract Value Portability, the Contingent Deferred Sales Charge and the Contract Management Charge will not be less favorable after the termination of this Agreement on June 30, 1999, than the provisions contained in this Letter Agreement.

3.) Participants shall have access to a Voice Response Unit (VRU) which will provide the following information to the participant from a touch-tone telephone:

(i) Current account balance, in total and broken down by fund

(ii) Current interest rates

(iii) Current variable fund unit values and/or share prices

(iv) Daily changes in variable fund unit values and/or share prices

(v) Current contribution allocation percentages

The VRU System will also allow participants to make the following transactions:

(a) Change the allocation of future contributions

(b) Process transfers between fund investment options

Account information available from VRU will utilize the most currently available share prices, unit values and account balances. The VRU system is available 24 hours a day, except for routine maintenance of the system, which generally takes place between the hours of 12:00 a.m. and 12:00 p.m. each Sunday morning. However, the VRU system may be unavailable at other times, if necessary, for system maintenance.

4.) The Insurance Company agrees to furnish data about itself (including, but not limited to, financial data permitting an assessment of its credit worthiness) and/or its annuity contracts when requested by the State Board of Investment. In addition, the books, records, documents and accounting procedures and practices of the Insurance Company relevant to this Contract shall be subject to examination by the State Board of Investment and the Minnesota legislative auditor.

5.) The minimum Guaranteed Interest Rate applicable to the Guaranteed Certificate Fund and referenced in the Guaranteed Certificate Fund Rider is 3.00% effective September 1, 1994 and guaranteed for the term of the agreement.

6.) The following FutureFunds II investment options have been selected by the Group Policyholder for deposits received after September 1, 1994:

- Guaranteed Certificate Fund

  - 84 month certificate
  - 36 month certificate

- Variable Options

  - Money Market Fund - Great-West Money Market Portfolio
  - Balanced Fund - Fidelity Advisor Income & Growth Fund
  - International Equity Fund - Great-West International Equity Portfolio, subadvised by Templeton
  - Bond Fund - Voyageur U.S. Government Securities Fund
  - Equity Funds - Twentieth Century Ultra Investors

    Great-West Growth Fund I, subadvised by Janus

    Vista Growth & Income Fund

The Group Policyholder may add additional FutureFunds II in investment fund options as offered by Insurance Company upon 30 days advance written notice to Insurance Company.

The Variable Fund Series Accounts are separate accounts subject to state law. By law, the assets of the separate account must be owned by the Insurance Company, not by the

Group Policyholder. Thus, the Series Accounts must be owned by Great-West Life & Annuity. However, that fact does not negate the fact that all of the Plan assets invested in the Group Annuity Contract are owned by the Group Policyholder. The Group Policyholder owns the insurance contract which is secured by the assets in the Series Accounts owned by the Insurance Company.

Under Colorado law, a separate account is insulated from the claims of the Insurance Company's other policyholders and creditors. C.R.S. §10-7-402. Colorado Insurance law specifically codifies the National Association of Insurance Commissioners (NAIC) Model Variable Contract Law insulation provision by stating that "[t]o the extent provided in the applicable contracts, that portion of the assets of any such separate account shall not be chargeable with liabilities arising out of any other business the Company may conduct." C.R.S. §10-7-401(e). Thus, the assets in the Series Account are actually insulated from liabilities arising out of any other business the Insurance Company may conduct.

Insurance law providing separate account insulation acts in concert with applicable liquidation laws. In the Colorado Rehabilitation and Liquidation statute, separate account assets do not fall within the definition of general assets of an insurer which are subject to liquidation. Therefore, read together, the separate account provisions and the rehabilitation and liquidation provision of the Colorado Insurance Code indicate that separate account policyholders would be the only parties entitled to share in the separate account assets. Thus, the assets in the Series Account will be available to the Group Policyholder to the extent of the assets in their Group Annuity Contract which are invested in the Series Account.

7.) The following investment fund options will be eliminated effective September 1, 1994 and those participants who do not submit a new investment election and transfer instructions will have their fund balances transferred to the following "Default" fund options effective September 1, 1994.

| **Eliminated Fund Options** | TO | **"Default Fund Options** |
|---|---|---|
| Daily Interest Guarantee Fund | | Fidelity Advisor Income & Growth Fund |
| Great-West Bond Portfolio | | Voyageur U.S. Government Securities Fund |
| Great-West Stock Index Portfolio | | Great-West Growth Fund I subadvised by Janus |
| 60-Month Guaranteed Certificate Fund Option | | Maturity Reinvestment 84-Month Guaranteed Certificate Fund Option |

In addition, all deferrals and maturing certificates that are directed to the discontinued options will automatically be redirected to the applicable default fund options listed above until new allocation instructions for new deferrals and maturing certificates are provided by the participant to the Insurance Company.

8.) Guaranteed Contract Value Portability

Participants may transfer their maturing certificates into any Great-West Variable Sub-Account or have them renew into a new 36-month or 84-month Certificate. The Insurance Company will advise Participants at least 60 days in advance of the expiration of any maturing certificate and will advise Participants of available options and the reinvestment option in which participants will be placed in the event the participant makes no election. If the participant does not make an election, his/her balance in the maturing Certificate will automatically be reinvested in a new Certificate with the same term to maturity as the original Certificate.

Funds in the 60-month certificates will automatically be reinvested at maturity to an 84-month certificate unless otherwise elected by the participant.

At the maturity of each Certificate, participants will not have the option of transferring the maturing amount directly to non-Great-West funds.

9.) Variable Contract Value Portability

Transfers among Great-West's Variable Sub-Accounts and transfers to the Great-West Guaranteed Certificate Fund Option will be permitted at any time, with no limits and no charges.

Once each calendar year participants may transfer up to 40% of the current value of the participant's Variable Contract Value to non-Great-West funds, with no transfer fee effective September 1, 1994. Commencing January 1, 1995, once each year thereafter, participants may transfer up to the greater of $1,000 or 40% of their Variable Contract Value to non-Great-West funds, with no transfer fee.

10.) The costs of developing and printing enrollment and/or application forms, beneficiary forms, transfer forms, brochures describing the Plan, products and investment options, brochures containing performance and risk comparison, or any other printed materials required in connection with the Plan shall be shared by the product providers and MSRS for the Supplemental Investment Fund on a pro rata basis, based on each investment party's pro rata share of total plan assets.

Insurance Company agrees to provide developmental and, if requested, printing services to MSRS to the extent permitted by law, subject to control by MSRS, in connection with such forms, brochures and materials. If such services are provided by Insurance Company, the cost of such services shall be subject to verification by MSRS and billed directly to MSRS by the Insurance Company. MSRS will then bill the product providers and SBI on the pro-rata basis described above. Such bills shall detail the actual cost to be remitted by the Insurance Company to the Group Policyholder with a detailed breakdown of how the cost was determined.

In the event that the Insurance Company's pro-rata share of such fees exceeds **$150,000.00** during the Contract term, the Insurance Company reserves the right to adjust its existing certificate interest rates and the risk charge on existing assets in the Variable Sub-Accounts.

11.) a) Insurance Company understands and agrees that MSRS may enter into separate agreements with Plan Marketing Organizations which will enroll and provide service to participants in the Plan. Subject to the approval of the SBI, MSRS, not the Insurance Company, is responsible for hiring, directing and supervising, terminating and compensating any Plan Marketing Organizations. Insurance Company agrees that it will not provide any compensation to any Plan Marketing Organization or to any individual agent employed by such a firm in connection with services provided to the Plan.

b) Insurance Company agrees to make the new Group Annuity Contract terms and provisions available to the Plan Marketing Organizations for offer to Plan participants. In that regard, Insurance Company will enter into such selling agreements as are necessary to make the new Group Annuity Contract terms and provisions available to the Plan Marketing Organizations and will also appoint as its agents such employees of the Plan Marketing Organizations as are necessary. Failure to cooperate with Plan Marketing Organizations, subject to right to cure, is grounds for termination under Section 15. of this Agreement and Section 12. of the Group Annuity Contract.

c) MSRS shall have sole responsibility for ensuring that the Plan Marketing Organizations provide fair and equal presentations of all investment options available under the Plan and that the compensation paid to the Plan Marketing Organizations represents the entire compensation received by any Plan Marketing Organization with regard to the Plan and that no other emoluments will be paid. Upon request by Insurance Company, SBI shall request MSRS to provide reasonable assurances to Insurance Company that such fair and equal presentations are being made. The Agreements with the different Plan Marketing Organizations shall be substantially identical in form and content and the requirements of the MSRS shall be consistently applied to all Plan Marketing Organizations.

Disputes, if any, between the Investment Product Providers, SBI and/or MSRS over the presentation of products or rates of return and materials prepared by the Plan Marketing Organizations shall be resolved by a Plan consultant retained by the SBI. Costs of the SBI consultant for dispute resolution procedures shall be borne by the Product Provider or Providers initiating the dispute resolution process.

12.) a) The Insurance Company will pay a fee in the first year equal to 0.07% annually to the MSRS, based upon the assets invested with the Insurance Company by Plan participants for administrative services. This payment will be paid on a monthly basis and will be based upon the non-annuitized plan assets on deposit with the Insurance Company as of the last day of the month. Systematic withdrawal or Periodic Payment assets are not deemed to be annuitized balances. The amount of the annual fee in subsequent years is to be determined by the SBI and may be changed from time to time. The Insurance Company reserves the right to change its Risk Charge on variable options and its interest credited rate on existing certificates if the Group Policyholder's administration fee changes.

b) Insurance Company agrees to make payments to Plan Marketing Organizations, or where necessary, to the Broker Dealer with which the employees of the Plan Marketing Organizations are registered to reimburse it for marketing services provided in connection with the Plan, as follows:

At the end of each calendar month, Insurance Company will remit to the MSRS a payment which is equal, on an annual basis, to a percentage, which shall be the percentage rate set forth in Section 5. of the applicable agreement between MSRS and the Plan Marketing Organizations of the then current accumulation values (estimated monthly and reconciled to actual accumulation values quarterly) held under the Group Annuity Contract. Accumulation values for this purpose shall not include amounts which have been applied to purchase any annuity option, but shall include amounts held for systematic withdrawal.

The amount of this monthly payment, with respect to accumulation values under the Group Annuity Contract, may be adjusted from time to time by the SBI.

c) Whenever accumulation values under the Group Annuity Contract are applied to provide any annuity option, which for this purpose shall not include amounts held for systematic withdrawal, Insurance Company shall make a one-time payment to Plan Marketing Organizations, or where necessary, to the Broker Dealer with which the employees of the Plan Marketing Organizations are registered in an amount equal to 1.5% of the amount applied to provide such annuity.

The SBI agrees that the percentage rate of reimbursement for marketing and administration services shall be identical for all Product Providers.

13.) To the extent permitted by law, the Insurance Company will reimburse the SBI for the Insurance Company's pro-rata share (determined by dividing the total cost amongst the number of product providers) incurred by SBI, including consultant fees, for its review of the Deferred Compensation Program, up to a maximum of $50,000 for the life of the contract, without prior consent of the Insurance Company. Payment shall be made based on an invoice prepared and submitted by the SBI. The invoice schedule will be determined by the SBI but the Insurance Company will be invoiced no more often than quarterly. Payments are due 30 days from the date of receipt of the invoice by Insurance Company.

14.) <u>Contract Termination</u>

The Group Policyholder will have an unconditional ability to terminate this contract on June 30, 1999.

15.) <u>Contract Termination for Cause</u>

Subject to Insurance Company's right to cure, the Contract may be terminated by Group Policyholder for cause at any time during the Contract term upon sixty (60) days written notice to Great-West Life.

"Cause" is defined as :

- Malfeasance
- Misfeasance
- Fraud
- Failure to perform any provision of the contract, subject to the Insurance Company having 90 days to cure any failure of contract performance.
- Failure to maintain a crediting rate on new Fixed Certificates that is the greater of (1) 3.00% or (2) the yield on comparable maturity U.S. Treasury notes as of the date of the initial rate declaration, less 2.5%.
- A material change in the Insurance Company's financial position, defined as the occurrence of two or more of the following:

  Standard & Poor's rating falls to A+ or lower,

  Moody's rating falls to A3 or lower,

  Duff & Phelps rating falls to A+ or lower, and/or

A.M. Best rating falls A- or lower.

- However, in the event of any drop in ratings that is a result of a re-calibration of the life insurance industry by any of the aforementioned rating agencies, the parties will use best efforts to cause this provision to be amended consistent with any such recalibration by the parties to the Letter Agreement.

16.) Options at Contract Termination

In the event that the contract is terminated, either on the contract expiration date or before, the contract will include the following termination options:

a) A market value adjustment formula that will apply to Fixed Certificate balances only, and will not apply to variable fund balances. The formula is as follows:

- Applicable to the Guaranteed Certificate Fund, a Market Value Adjustment will be calculated based on the account value of the Guaranteed Certificate Funds multiplied by the Market Value Adjustment Factor. The Market Value Adjustment Factor is calculated for the entire Group Policyholder account. The same factor will be applied to each individual account.

- The Market Value Adjustment Factor will be determined by taking the sum of the discounted maturity values of each certificate within the Guaranteed Certificate Fund as of the Date of Cessation of Deposits, then dividing by the value of all individual participant accounts in the Guaranteed Certificate Fund on the Premium Cessation Date. The Market Value Adjustment Factor will not exceed 1.00.

- Discounting is calculated by using an interest rate equal to the larger of the 1) Moody's Baa Corporate Bond Yield Average for the middle month of the calendar quarter in which the certificate was established, or 2) Moody's Baa Corporate Bond Yield Average 60 days prior to the Premium Cessation Date.

The Insurance Company will pay the sum of the market value adjusted certificates in respect of participants to an investment company designated in writing by the Group Policyholder as the successor insurer of the Plan or to the Group Policyholder within one hundred and eighty (180) days after the Date of Cessation of Deposits.

The Insurance Company will pay the sum of the Variable Contract Values in respect of participants to a new investment company designated in writing by the Group Policyholder as the successor insurer of the Plan or to the Group Policyholder within seven (7) days after the Date of Cessation of Deposits.

If the Date of Cessation of Deposits occurs within eighteen (18) months of the commencement date of the contract, a transfer fee of one half of one percent (.5%) will be deducted from the distribution of any Guaranteed Contract Values and Variable Contract Values. The Transfer Fee is applied after the calculation of the Market Value Adjustment.

b) No new contributions will be accepted to the Insurance Company program, but participants will continue to direct the investment of their existing balances under the program and receive benefit payments under the program, subject to the provisions of Section 12.2.a. of the Group Annuity Contract.

c) Twenty quarterly installment payments of Guaranteed Contract Values. The minimum payment will be $514.80 per $10,000 of Guaranteed Contract Values. Variable Contract Values will be paid out within 7 days, subject to the provisions of Section 12.2.b. of the Group Annuity Contract.

Participants who have commenced receiving an annuity will not be affected by termination of the Group Annuity Contract, its Application, Tables, Guaranteed Sub Account Riders or Letter Agreement.

17.) For the term of this Letter Agreement the following factors will be used to determine a current installment payout factor per $10,000.00 of Guaranteed Contract Values. The 20 equal installment amounts described in Section 12.2.b, Cessation Option (2) Installment Settlement of Contract Values of the Contract:

- According to the change in the general level of interest rates in the economy (and hence the market values of the assets backing the plan), and

- The amount of unamortized expenses in the program.

In no event will the amount of the installment be less than $514.80 per $10,000.00 of Guaranteed Contract Values.

18.) a) When making any benefit payments in accordance with the Plan, Insurance Company shall report to the Internal Revenue Service the amounts of such payments in accordance with Internal Revenue Service requirements.

b) Insurance Company agrees to withhold federal and state income taxes from benefit payments in accordance with instructions from the Plan participant's employer as to the amounts to be withheld, or as is otherwise required by the Internal Revenue Service or by appropriate state tax authorities.

c) Insurance Company agrees that, with respect to matters relating to the Plan, Insurance Company will make information from its participant account records available to the SBI, MSRS and the Plan Marketing Organizations upon request. Insurance Company shall provide, at its expense, software to allow the Plan Marketing Organizations and MSRS access to Insurance Company's system of Plan participant information relating to the Group Annuity Contract. All parties agree that Plan participant records are private and that only Insurance Company, the SBI, MSRS, and the Plan Marketing organizations where necessary, shall have access to such records.

19.) Insurance Company agrees to comply in all areas with:

a) Rules of the Plan (when not inconsistent with this Agreement and the Group Annuity Contract) which have been approved by the SBI to the extent required by Minnesota Statute Section 352.96, subd. 3 (1993 Supp.) and filed with the Minnesota Secretary of State and Revisor of Statutes;

b) Minnesota Statutes 19942, Section 352.96 (1992 and 1993 Supp.), and any amendments thereto, provided such amendments do not impair a material provision of the Group Annuity Contract and this Agreement; and

c) 457 of the Internal Revenue Code of 1986, as amended, or any rules and regulations thereunder.

20.) No amendment to this Agreement shall be effective unless such amendment shall be in writing and signed by all of the parties hereto.

21.) Any notice under this Agreement must be in writing and may be given by or on behalf of Insurance Company by delivering the same to the SBI or by mailing it to the SBI at its address of record with Insurance Company, and any notice to Insurance Company given by the SBI shall be in writing and mailed to Insurance Company at its Home Office. Any such notice shall be effective on the date of receipt unless the terms of this Agreement dictate otherwise.

22.) This Agreement shall be construed according to the laws of Minnesota.

23.) Insurance Company hereby agrees to indemnify and hold harmless the State of Minnesota, the Minnesota State Board of Investment, each member of the Board individually, the officers, agents and employees of each and every of the above, their successors, and any combination thereof, from all claims, demands, or causes of action arising out of an act or omission of Insurance Company related to this Agreement and the Group Annuity Contract.

Insurance Company shall reimburse the Board for all reasonable expenses incurred to defend and legal proceedings that may be brought against the State of Minnesota, the Minnesota State Board of Investment, each member of the Board individually, the officers, agents and employees of each and every of the above, their successors, and any combination thereof, on any claim or demand effected by this section, and shall satisfy any judgment that may be rendered against such party or parties in respect to any such claim or demand. The Board shall notify Insurance Company upon receipt of any such claim or demand which it receives. Pursuant to Minnesota Statutes section 8.06, the Minnesota Attorney General (or its designee) shall be the legal counsel for the State of Minnesota, the Board, the members of the Board individually, and the officers, agents and employees of the Board or the State of Minnesota.

24.) Insurance Company certifies that it has received a certificate of compliance from the Commissioner of Human Rights pursuant to Minnesota Statutes section 363.073.

25.) To the extent that Insurance Company has access to data of the State entities which is classified as private, nonpublic or confidential pursuant to the Minnesota Government Data Practices Act, Minnesota Statutes chapter 13, the Insurance Company agrees to comply with the requirements of Minnesota Statutes chapter 13 in providing services under this Agreement and the Group Annuity Contract. Insurance Company agrees to indemnify, save and hold harmless the State of Minnesota, the Minnesota State Board of Investment, each member of the Board individually, the officers, agents and employees of each and every of the above, from all claims, demands, or causes of action arising out of, resulting from any act or omission of Insurance Company or in any violation by Insurance Company of any provision of the Minnesota Government Data Practices Act, Minnesota Statutes chapter 13, including legal fees and disbursements paid or incurred to enforce this provision of this Agreement and the Group Annuity Contract. In the event Insurance

Company subcontracts any or all of the work to be performed under this Agreement and the Group Annuity Contract, Insurance Company shall retain responsibility under this paragraph for compliance with the Minnesota Government Data Practices Act.

26.) Any waiver at any time by either party hereto of any right with respect to any matter arising in connection with this Agreement and the Group Annuity Contract shall not be deemed to be a waiver with respect to any subsequent matter.

27.) Insurance Company shall assign to the State of Minnesota any and all claims for overcharges as goods and/or services provided in connection with this Agreement and the Group Annuity Contract resulting from antitrust violations which arise under the antitrust laws of the United States and the antitrust laws of the State of Minnesota.

28. Ongoing Obligations. The provisions of Sections 1, 2, 3, 4, 6, 8, 9, 12, 18, 19, 23 and 25 shall survive any termination of this Letter Agreement.

IN WITNESS WHEREOF, the Parties have, by their duly authorized officers or representatives, executed ______ counterparts of this Letter Agreement, intending to be bound thereby.

**State Board of Investment**

By: ________________________________ ________________Date

Name: ________________________________

Title: ________________________________

**Minnesota State Retirement System**

By: ________________________________ ________________Date

Name: ________________________________

Title: ________________________________

**Great-West Life & Annuity Insurance Company**

By: ________________________________ ________________Date

Name: ________________________________

Title: ________________________________

By: ________________________________ ________________Date

Name: ________________________________

Title: ________________________________

STATE OF MINNESOTA
THE OFFICE OF THE ATTORNEY GENERAL

By: ____________________________

Name: ____________________________

Title: ____________________________

STATE OF MINNESOTA
DEPARTMENT OF ADMINISTRATION

By: ____________________________

Name: ____________________________

Title: ____________________________

STATE OF MINNESOTA
DEPARTMENT OF FINANCE

By: ____________________________

Name: ____________________________

Title: ____________________________

# Annuity Contract and Business Agreement with Minnesota Mutual

**MINNESOTA MUTUAL**

The Minnesota Mutual Life Insurance Company • 400 Robert Street North • St. Paul, Minnesota 55101-2098 • (612) 298-3500

**CONTRACT OWNER:**

**CONTRACT NUMBER:**

**EFFECTIVE DATE:**

**CONTRACT ANNIVERSARY:**

**JURISDICTION:**

**PLAN:**

The Minnesota Mutual Life Insurance Company (herein called Minnesota Mutual) agrees to accept purchase payments hereunder from the Contract Owner, to account for such purchase payments in the manner provided herein, and to pay contract benefits in such amounts and to such persons as are designated in writing by the Contract Owner or its designee.

This contract is issued in consideration of the application by the Contract Owner, a copy of which is attached to, and made a part of this contract, and the tender of purchase payments under this contract by the Contract Owner. Minnesota Mutual agrees to make annuity and other payments in accordance with the provisions on this and the subsequent pages, all of which are a part of this contract.

This contract shall be governed by the laws of the jurisdiction indicated above. This contract is executed by Minnesota Mutual at its Home Office in Saint Paul, Minnesota, to take effect as of the Effective Date.

Secretary | President

Registrar

**GROUP DEFERRED VARIABLE ANNUITY CONTRACT**
**ALLOCATED**
**PROVISION FOR FIXED AND VARIABLE ANNUITY PAYMENTS**

**ALL PAYMENTS AND VALUES PROVIDED BY THIS CONTRACT, WHEN BASED ON THE INVESTMENT EXPERIENCE OF A SEPARATE ACCOUNT, ARE VARIABLE AND NOT GUARANTEED AS TO FIXED DOLLAR AMOUNT**

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## SECTION 1. DEFINITIONS

### 1.01 PLAN

"Plan" means the Plan specified on Page 1 of this contract. The Plan must meet the requirements for qualification under Section 457 of the Internal Revenue Code, as amended, or other section of the Code allowing similar tax treatment.

### 1.02 PARTICIPANT

A person eligible to participate under the Plan, and on whose behalf purchase payments have been or are being made under this contract.

### 1.03 ANNUITANT

A person eligible to receive lifetime benefits under this contract. Joint annuitants will be considered a single entity.

### 1.04 ANNUITY PAYMENTS

A series of payments made at regular intervals to the Annuitant or any other payee. Annuity Payments will be due and payable only on the first day of a calendar month.

### 1.05 FIXED ANNUITY

An annuity payable from the General Account, with payments which remain fixed as to dollar amount throughout the period of Annuity Payments.

### 1.06 VARIABLE ANNUITY

An annuity payable from the Separate Account with payments which increase or decrease in dollar amount to reflect the investment experience of the sub-accounts of the Separate Account.

### 1.07 ANNUITY COMMENCEMENT DATE

The date upon which Annuity Payments begin, as determined in accordance with the Plan.

### 1.08 GENERAL ACCOUNT

All assets of Minnesota Mutual other than those in Separate Accounts established by Minnesota Mutual.

**1.09 SEPARATE ACCOUNT**

A separate investment account titled Minnesota Mutual Group Variable Annuity Account. This Separate Account was established by Minnesota Mutual for this class of contract under Minnesota law. The Separate Account is composed of several sub-accounts. The assets of the Separate Account belong to Minnesota Mutual and shall be held and applied exclusively for the holders of those contracts on a variable basis for which the Separate Account has been established. Those assets are not subject to claims arising out of any other business which Minnesota Mutual may conduct.

**1.10 PARTICIPANT'S ACCUMULATION VALUE**

The sum of the individual Participant's values under this contract in the General Account and/or the Separate Account. In the General Account, this is the General Account Accumulation Value. In the Separate Account, this is the Separate Account Accumulation Value. The Separate Account portion is composed of the Participant's interests in one or more sub-accounts of the Separate Account. The total of these shall be the Participant's Separate Account Accumulation Value. Interests in the sub-accounts shall be valued separately.

**1.11 FUND**

The mutual fund or separate investment portfolio within a series mutual fund which is designated as an eligible investment for the Separate Account.

**1.12 VALUATION DATE**

Any date on which a Fund is valued.

**1.13 VALUATION PERIOD**

The period between successive valuation dates measured from the time of one determination to the next.

**1.14 PARTICIPATION YEAR**

A period of one year beginning on the first day of the month in which purchase payments were first received under this contract on behalf of a Participant, or on an anniversary of that date.

**1.15 UNIT**

A measure of a Participant's interest in the Separate Account or sub-account of the Separate Account.

## 1.16 1940 ACT

The Investment Company Act of 1940, as amended, or any similar successor federal legislation.

## SECTION 2. PURCHASE PAYMENTS

### 2.01 AMOUNT OF PURCHASE PAYMENTS

The amount of purchase payments to be paid by the Contract Owner by or on behalf of a Participant shall be determined by the Contract Owner in accordance with the provisions of the Plan. All purchase payments are payable at the Home Office of Minnesota Mutual. The Home Office is at 400 Robert Street North, St. Paul, Minnesota 55101-2098.

### 2.02 APPLICATION OF PURCHASE PAYMENTS

There are usually no deductions made from purchase payments. However, Minnesota Mutual reserves the right to make a deduction from purchase payments for state premium taxes, where applicable.

### 2.03 ALLOCATION OF PURCHASE PAYMENTS

Purchase payments may be allocated to the General Account or to the sub-accounts of the Separate Account. Purchase payments for each Participant shall be allocated to the General Account or to the sub-accounts of the Separate Account in accordance with the instructions of the Participant or the Contract Owner. The initial allocation is established as specified in the application for participation under this contract which must be signed by the Participant. The allocation may be changed as to future purchase payments by written notice to Minnesota Mutual from the Participant or Contract Owner. That notice must be received by Minnesota Mutual at its Home Office on or prior to the date of receipt of those future purchase payments.

### 2.04 SEPARATE ACCOUNT ALLOCATION

Amounts allocated to the sub-accounts of the Separate Account will be applied by Minnesota Mutual to provide accumulation units. Minnesota Mutual will determine the number of accumulation units by dividing the purchase payment by the then current accumulation unit value. That determination will be made as of the Valuation Date coincident with or next following the date on which such purchase payment is received by Minnesota Mutual at its Home Office, and shall be made separately for purchase payments allocated to each of the sub-accounts. The number of accumulation units so determined shall not be affected by any subsequent change in the accumulation unit value.

The Separate Account is divided into sub-accounts. For each sub-account there is a Fund for the investment of that sub-account's assets. Amounts are invested in the Funds at their net asset value. Purchase payments may be applied to one or more of the sub-accounts. Minnesota Mutual reserves the right to add, combine or remove any sub-accounts of the Separate Account.

If investment in a Fund should no longer be possible or if Minnesota Mutual determines it to be inappropriate for contracts of this class, another Fund may be substituted. Substitution may be with respect to existing Accumulation Values, future purchase payments and future Annuity Payments.

## 2.05 CHANGES TO THE SEPARATE ACCOUNT

Minnesota Mutual reserves the right to transfer assets of the Separate Account to another Separate Account. The transfer will be of assets associated with this class of contracts, as determined by Minnesota Mutual. If this type of transfer is made, the term "Separate Account", as used in this contract, shall then mean the Separate Account to which the assets were transferred.

Minnesota Mutual reserves the right, when permitted by law, to:

(a) de-register the Separate Account under the Investment Company Act of 1940;

(b) restrict or eliminate any voting rights of contract owners or other persons who have voting rights as to the Separate Account; and

(c) combine the Separate Account with one or more other Separate Accounts.

## SECTION 3. CONTRACT CHARGES

### 3.01 DEFERRED SALES CHARGE

The deferred sales charge is the charge made on Participant withdrawals during the first six Participation Years. The amount withdrawn plus any deferred sales charge is deducted from the Participant's Accumulation Value. In the Separate Account, accumulation units will be cancelled of a value equal to the charge and withdrawal.

The charge is indicated in the table shown below. These percentages decrease uniformly by .083% for each of the first 72 months of participation.

| End of Participation Year | Charge |
|---|---|
| (Participation Date) | 6.0% |
| 1 | 5.0% |
| 2 | 4.0% |
| 3 | 3.0% |
| 4 | 2.0% |
| 5 | 1.0% |
| 6 | 0 % |

In no event will the amount of deferred sales charge exceed 9% of the total purchase payments made on behalf of each Participant.

### 3.02 SEPARATE ACCOUNT CHARGES

There are three charges which are imposed by Minnesota Mutual on the assets of the Separate Account. They are the mortality risk charge, the expense risk charge and the administrative charge. These charges are deducted on each Valuation Date from the assets of the Separate Account.

The mortality risk charge is for the mortality guarantees Minnesota Mutual makes under the contract. Actual mortality results incurred by Minnesota Mutual shall not adversely affect any payments or values under this contract. On an annual basis, this charge shall not exceed .60% of the net asset value of the Separate Account.

The expense risk charge is for the guarantee that the deductions provided in this contract will be sufficient to cover its expenses. Actual expense results incurred by Minnesota Mutual shall not adversely affect any payments or values under this contract. On an annual basis, this charge shall not exceed .65% of the net asset value of the Separate Account.

The administrative charge is designed to cover the administrative expenses incurred by Minnesota Mutual under this contract. On an annual basis, this charge shall not exceed .40% of the net asset value of the Separate Account.

## SECTION 4. VALUATION

### 4.01 PARTICIPANT'S ACCUMULATION VALUE

A Participant's General Account Accumulation Value as of any date is the sum of the following transactions made on behalf of a Participant: all purchase payments allocated to the General Account plus interest, dividends and transfers into the General Account, less any transfers out of the General Account, any previous withdrawals and any applicable deferred sales charge.

A Participant's Separate Account Accumulation Value is the sum of the Participant's interest in each sub-account of the Separate Account which is equal to the number of accumulation units held on behalf of the Participant multiplied by the accumulation unit value for the appropriate sub-account of the Separate Account.

### 4.02 ACCUMULATION UNIT VALUE

The accumulation unit value for each sub-account of the Separate Account will be valued on each Valuation Date according to the net investment experience of that sub-account. The value of an accumulation unit for each sub-account was originally set at $1.00 on the first Valuation Date. For any subsequent Valuation Date, its value is equal to its value on the preceding Valuation Date multiplied by the net investment factor for that sub-account for the valuation period ending on the subsequent Valuation Date.

### 4.03 NET INVESTMENT FACTOR

The net investment factor for a valuation period is the gross investment rate for such valuation period, less a deduction for the charges associated with the Separate Account at a rate of no more than 1.65% per annum.

The gross investment rate is equal to:

(a) the net asset value per share of a Fund share held in the sub-account of the Separate Account determined at the end of the current valuation period; plus

(b) the per-share amount of any dividend or capital gain distributions by the Fund if the "ex-dividend" date occurs during the current valuation period; divided by

(c) the net asset value per share of that Fund share held in the sub-account determined at the end of the preceding valuation period.

### 4.04 ANNUITY UNIT VALUE

The value of an annuity unit for a sub-account is determined monthly as of the first day of the month. The value is equal to the annuity unit value for that sub-account as of the first day of the preceding month multiplied by the product of (a) .996338; and (b) a sub-account investment factor. This investment factor is the accumulation unit value for that sub-account on the Valuation Date next following the fourteenth day of the preceding month divided by the accumulation unit value for that sub-account on the Valuation Date next following the fourteenth day of the second preceding month. For any date other than the first of a month, the annuity unit value is that value on the first day of the next month.

### 4.05 GENERAL ACCOUNT INTEREST

Interest will be credited to amounts allocated to the General Account at such interest rate as may be declared from time to time by Minnesota Mutual for this contract, in accordance with its usual practices for contracts of this class. Interest will be credited at a rate of no less than 3% per year, compounded annually.

## SECTION 5. WITHDRAWALS AND TRANSFERS

### 5.01 WITHDRAWAL PROVISIONS

Withdrawals may be made only for the purpose of:

(a) providing Plan benefits in accordance with Section 6,

(b) transfers to the Contract Owner in accordance with Section 7.03,

(c) transfers to Plan options available to Participants other than those provided for in this Contract, or

(d) other withdrawals as allowed in the Plan and mutually agreed upon by Minnesota Mutual and the Contract Owner.

The amount available for withdrawal shall be the Participant Accumulation Value less any applicable deferred sales charge. If withdrawals during the first calendar year of participation are equal to or less than 10% of the total purchase payments made on behalf of the Participant, the charge will not apply. In subsequent calendar years there will be no charge for withdrawals equal to or less than 10% of the prior calendar year Participant Accumulation Value. If a Participant's withdrawals in any calendar year exceed this amount, the deferred sales charge will apply to the excess.

Withdrawal amounts shall be deducted from the Participant's General Account Accumulation Value on a first in, first out (FIFO) basis. Unless otherwise instructed by the Participant or the Contract Owner, withdrawal amounts will be made from a Participant's interest in the General Account and each sub-account of the Separate Account in the same proportion that the value of that Participant's interest in the General Account and any sub-account bears to that Participant's total Accumulation Value.

Withdrawals are made upon written request from the Participant or Contract Owner to Minnesota Mutual. The withdrawal date will be the Valuation Date coincident with or next following the receipt of the request by Minnesota Mutual at its Home Office.

From the General Account, withdrawals as described in (c) above, in combination with transfers as described in 5.03, will be limited to the greater of $1,000 or 10% of the Participant's General Account Accumulation Value in each calendar year. From the sub-accounts of the Separate Account, withdrawals as described in (c) above will not be limited as to amount. Such withdrawals may be taken once per year or in 12 monthly installments.

## 5.02 TRANSFER OF PARTICIPANT'S ACCUMULATION VALUE

Transfers of a Participant's Accumulation Value may be made among the Participant's General Account and the sub-accounts of the Separate Account. Such a transfer is made upon the written request from the Participant or Contract Owner to Minnesota Mutual. The transfer date will be the Valuation Date coincident with or next following the receipt of the transfer request by Minnesota Mutual at its Home Office.

## 5.03 TRANSFERS OF THE GENERAL ACCOUNT

All transfers of General Account Accumulation Value of the Participant's Account shall be on a first in, first out (FIFO) basis. In each calendar year, amounts withdrawn by Participants for transfer to other Plan options, as described in 5.01(c), combined with amounts transferred from the Participant's General Account Accumulation Value to the sub-accounts of the Separate Account, may not exceed the greater of $1,000 or 10% of their General Account Accumulation Value. Transfers are permitted once per year or in 12 monthly installments.

## 5.04 TRANSFERS FROM THE SEPARATE ACCOUNT

For transfers from the sub-accounts of the Separate Account, a number of Accumulation Units will be surrendered such that the Accumulation Value of the surrendered Accumulation Units equals the amount transferred. Transfers between the sub-accounts of the Separate Account are unlimited as to amount and frequency.

## SECTION 6. BENEFIT PROVISIONS

### 6.01 DEATH BENEFITS

In the event of the death of a Participant prior to the Annuity Commencement Date, the beneficiary of that Participant will receive as a death benefit the greater of: (a) the Participant's Accumulation Value, determined as of the Valuation Date coincident with or next following the date due proof of death is received by Minnesota Mutual at its Home Office; or (b) the total of the Participant's purchase payments received by Minnesota Mutual less any prior Participant withdrawals. The death benefit will be paid in a single sum; or at the option of the beneficiary the death benefit may be applied under Option 2, or Option 4 of the Annuity Payment Options specified in Section 6.05, subject to the minimum payment requirements of Section 6.04.

### 6.02 ANNUITY COMMENCEMENT DATE

The Contract Owner or the Participant shall notify Minnesota Mutual in writing at its Home Office to begin Annuity Payments for a Participant, specifying the date such Annuity Payments are to commence. Unless otherwise permitted by the Plan, such date may be the first day of any calendar month provided that it may not be earlier than 30 days following the date such notice is given and provided further that it may not be later than April 1st of the calendar year following the calendar year in which the Participant attains age 70 1/2.

### 6.03 ELECTION OF ANNUITY OPTION

The Contract Owner or the Participant may elect to have Annuity Payments made under any of the Annuity Payment Options described in Section 6.05, provided such election is received in writing by Minnesota Mutual at its Home Office at least 30 days prior to the Annuity Commencement Date. If no such election is received by Minnesota Mutual, Annuity Payments will be made in accordance with Option 2A, a life income with a period certain of 120 months.

### 6.04 APPLICATION OF ACCUMULATION VALUE

As of the Annuity Commencement Date, Minnesota Mutual shall apply the Participant's Accumulation Value to provide Annuity Payments under the Annuity Payment Option determined in accordance with Section 6.03; provided, however, that the first monthly payment under such Annuity Payment Option must be at least $20.00 in amount. If such first monthly payment would be less than $20.00 in amount, the Participant's Accumulation Value will be paid to the Participant in a lump sum as of his Annuity Commencement Date, and the Participant shall thereafter have no further rights under this contract. The requirement that the first monthly payment be at least $20.00 shall be imposed separately for the portion of the Annuity Payments payable as a Fixed Annuity and the portion payable as a Variable Annuity under each of the sub-accounts of the Separate Account.

## 6.05 ANNUITY PAYMENT OPTIONS

Option 1 - Life Annuity - An annuity payable monthly during the lifetime of the Annuitant and terminating with the last monthly payment preceding the death of the Annuitant.

Option 2 - Life Annuity with a Period Certain of 120 months (Option 2A), 180 months (Option 2B), or 240 months (Option 2C) - An annuity payable monthly during the lifetime of the Annuitant, with the guarantee that if the Annuitant dies before payments have been made for the Period Certain elected, payments will continue to the beneficiary during the remainder of such Period Certain. The beneficiary may elect to receive the commuted value of the remaining guaranteed payments in a lump sum. The value will be based on the then current dollar amount of one payment and the same interest rate which served as a basis for the annuity.

Option 3 - Joint and Last Survivor Annuity - An annuity payable monthly during the joint lifetime of the Annuitant and a designated joint annuitant and continuing thereafter during the remaining lifetime of the survivor.

Option 4 - Period Certain Annuity - An annuity payable monthly for a Period Certain of from 5 to 20 years, as elected. If the Annuitant dies before payments have been made for the Period Certain elected, payments will continue to the beneficiary during the remainder of such Period Certain. The beneficiary may elect to receive the commuted value of the remaining guaranteed payments in a lump sum. The value will be based on the then current dollar amount of one payment and the same interest rate which served as a basis for the annuity.

Payments under any of these Annuity Payment Options will be determined in accordance with Section 6.07 for a Fixed Annuity and with Section 6.08 for a Variable Annuity. If, when Annuity Payments are elected, Minnesota Mutual is using annuity purchase rates for this class of contract which would result in larger Annuity Payments, they will be used instead of those guaranteed in this contract.

Minnesota Mutual reserves the right to require proof satisfactory to it of the age of a Annuitant and any joint annuitant prior to making the first payment under any Annuity Payment Option. Once Annuity Payments begin, the Annuity Payment Option may not be changed.

## 6.06 ELECTION OF ANNUITY FORM

Unless Minnesota Mutual shall be notified in writing to the contrary by the Contract Owner or Participant at least 30 days prior to the Annuity Commencement Date, General Account

Accumulation Value will be applied to provide a Fixed Annuity and Separate Account accumulation units will be applied to provide a Variable Annuity.

## 6.07 DETERMINATION OF FIXED ANNUITY PAYMENT

The tables contained in this contract are used to determine the amount of guaranteed fixed monthly Annuity Payments. They show the dollar amount of the monthly payment which can be purchased with each $1,000 of Participant Accumulation Value, after deduction of any applicable premium taxes not previously deducted under the provisions of Section 2.03 and a fee of $200. Amounts shown in the tables are based on the Progressive Annuity Table with interest at the rate of 3.0% per annum, assuming births in the year 1900, with an age setback of six years. The amount of each payment depends upon the adjusted age of the Participant and any joint annuitant. The adjusted age is determined from the actual age nearest birthday at the time the first payment is due in the following manner:

| Calendar Year of Birth | Adjusted Age is Equal to - |
|---|---|
| 1900-1919 | Actual Age |
| 1920-1939 | Actual Age Minus 1 |
| 1940-1959 | Actual Age Minus 2 |
| 1960-1979 | Actual Age Minus 3 |
| 1980 and Later | Actual Age Minus 4 |

GUARANTEED MINIMUM DOLLAR AMOUNT OF FIXED MONTHLY PAYMENT WHICH IS PURCHASED WITH EACH $1,000 OF VALUE APPLIED

| Adjusted Age of Annuitant | Single Life Annuities | | | |
|---|---|---|---|---|
| | Option 1 | Option 2A | Option 2B | Option 2C |
| 50 | $3.99 | $3.97 | $3.94 | $3.89 |
| 51 | 4.05 | 4.03 | 4.00 | 3.95 |
| 52 | 4.13 | 4.10 | 4.06 | 4.00 |
| 53 | 4.20 | 4.17 | 4.13 | 4.06 |
| 54 | 4.28 | 4.25 | 4.20 | 4.12 |
| 55 | 4.37 | 4.33 | 4.27 | 4.18 |
| 56 | 4.46 | 4.41 | 4.35 | 4.25 |
| 57 | 4.55 | 4.50 | 4.42 | 4.31 |
| 58 | 4.65 | 4.59 | 4.51 | 4.38 |
| 59 | 4.76 | 4.69 | 4.59 | 4.44 |

| | | | | |
|---|---|---|---|---|
| 60 | 4.87 | 4.79 | 4.68 | 4.51 |
| 61 | 4.99 | 4.90 | 4.77 | 4.58 |
| 62 | 5.12 | 5.01 | 4.86 | 4.65 |
| 63 | 5.26 | 5.13 | 4.96 | 4.72 |
| 64 | 5.40 | 5.25 | 5.06 | 4.79 |
| 65 | 5.56 | 5.39 | 5.16 | 4.85 |
| 66 | 5.72 | 5.52 | 5.27 | 4.92 |
| 67 | 5.90 | 5.67 | 5.37 | 4.99 |
| 68 | 6.09 | 5.82 | 5.48 | 5.05 |
| 69 | 6.29 | 5.97 | 5.59 | 5.11 |
| 70 | 6.51 | 6.13 | 5.69 | 5.16 |
| 71 | 6.74 | 6.30 | 5.80 | 5.21 |
| 72 | 6.99 | 6.48 | 5.90 | 5.26 |
| 73 | 7.26 | 6.66 | 6.01 | 5.31 |
| 74 | 7.54 | 6.84 | 6.11 | 5.34 |
| 75 | 7.86 | 7.03 | 6.20 | 5.38 |

Option 3 -- Joint and Last Survivor Life Annuity

| Adjusted Age of Joint Annuitant* | Adjusted Age of Annuitant* | | | | | | |
|---|---|---|---|---|---|---|---|
| | 55 | 60 | 62 | 65 | 67 | 70 | 75 |
| 54 | $3.80 | $3.93 | $3.98 | $4.04 | $4.08 | $4.13 | $4.19 |
| 59 | 3.95 | 4.14 | 4.21 | 4.32 | 4.38 | 4.46 | 4.57 |
| 61 | 4.00 | 4.22 | 4.31 | 4.43 | 4.50 | 4.61 | 4.75 |
| 64 | 4.07 | 4.34 | 4.44 | 4.60 | 4.70 | 4.83 | 5.03 |
| 66 | 4.12 | 4.41 | 4.53 | 4.71 | 4.82 | 4.99 | 5.23 |
| 69 | 4.17 | 4.50 | 4.65 | 4.86 | 5.01 | 5.23 | 5.56 |
| 74 | 4.25 | 4.64 | 4.81 | 5.09 | 5.29 | 5.60 | 6.11 |

*** Dollar amounts of the monthly payments for ages not shown in this table will be calculated on the same basis as those shown and may be obtained from us upon request.**

Option 4 -- Fixed Period Annuity

| Fixed Period (Years) | Dollar Amount of Payment | Fixed Period (Years) | Dollar Amount of Payment |
|---|---|---|---|
| 5 | $17.91 | 13 | $7.71 |
| 6 | 15.14 | 14 | 7.26 |
| 7 | 13.16 | 15 | 6.87 |
| 8 | 11.68 | 16 | 6.53 |
| 9 | 10.53 | 17 | 6.23 |
| 10 | 9.61 | 18 | 5.96 |
| 11 | 8.86 | 19 | 5.73 |
| 12 | 8.24 | 20 | 5.51 |

## 6.08 DETERMINATION OF VARIABLE ANNUITY PAYMENTS

The dollar amount of the first monthly variable Annuity Payment is determined by applying the Participant's Separate Account Accumulation Value (after deduction of any premium taxes not previously deducted) to a rate per $1,000 which is based on the Progressive Annuity Table with interest at the rate of 4.5% per annum, assuming births in the year 1900, with an age setback of six years. The amount of the first payment depends upon the annuity payment option selected and the adjusted age of the annuitant and any joint annuitant. The adjusted ages shall be determined using the same table as illustrated in Section 6.06 for determination of fixed Annuity Payments. A number of annuity units is then determined by dividing this dollar amount by the then current annuity unit value. Thereafter, the number of annuity units remains unchanged during the period of Annuity Payments. This determination is made separately for each sub-account of the Separate Account. The number of annuity units is based upon the available value in each sub-account as of the date Annuity Payments are to begin.

The dollar amount of the second and later variable Annuity Payments is equal to the number of annuity units determined for each sub-account multiplied by the annuity unit value for that sub-account as of the due date of the payment. This amount may increase or decrease from month to month.

The dollar amounts determined for each sub-account will be aggregated for purposes of making payment.

## 6.09 TRANSFERS DURING THE ANNUITY PERIOD

Participant amounts held as annuity reserves may be transferred among the Variable Annuity sub-accounts during the annuity period. The change must be made by written request. The annuitant and joint annuitant, if any, must make such an election.

A transfer will be made on the basis of annuity unit values. The transfer will be effective for future Annuity Payments and will occur the middle of the month preceding the next Annuity Payment affected by the transfer request. The number of annuity units from the sub-account being transferred will be converted to a number of annuity units in a new sub-account. The Annuity Payment option will not change. The first Annuity Payment after the transfer will be for the same amount as it would have been without the transfer. The number of annuity units will be set at that number of units which are needed to pay that same amount on the transfer date.

Transfers of annuity reserves from any sub-account must be at least equal to: 1) $5,000; or 2) the entire amount of reserve remaining in that sub-account. In addition, Annuity Payments must have been in effect for a period of 12 months before a change may be made. Such transfers are allowed only once every 12 months. The written request for transfer must be received by Minnesota Mutual at least 30 days in advance of the due date of the Annuity Payment subject to the transfer.

Amounts held as reserves to pay a Variable Annuity may also be transferred to provide a Fixed Annuity from the General Account, subject to the dollar amount and frequency limitations described above. The amount transferred will be applied to provide a Fixed Annuity amount of the same annuity option based upon the adjusted age of the annuitant and any joint annuitant at the time of the transfer. Once fixed Annuity Payments begin, the annuity reserves may not be transferred back to provide a Variable Annuity.

## 6.10 LUMP SUM SETTLEMENT

By written notice to Minnesota Mutual by the Contract Owner at least 30 days prior to the Annuity Commencement Date, a lump sum settlement of a Participant's Accumulation Value may be elected in lieu of the application of such value to provide Annuity Payments for the Participant under an Annuity Payment Option. After such lump sum settlement has been made, the Participant shall have no further rights under this contract.

## SECTION 7. SUSPENSION AND TERMINATION

### 7.01 SUSPENSION OF PURCHASE PAYMENTS

The Contract Owner may suspend purchase payments at any time by giving 60 days written notice to Minnesota Mutual of such suspension. The suspension may be with respect to all Participants, or only with respect to those Participants in such class or classes as are specified by the Contract Owner.

Except as to those Participants for whom purchase payments are suspended, the contract shall continue to operate during a period of suspension as if such suspension had not occurred. Purchase payments may be resumed at any time upon written notice to Minnesota Mutual by the Contract Owner.

### 7.02 TERMINATION OF CONTRACT

With 30 days written notice to Minnesota Mutual, the Contract Owner may terminate this contract at any time due to the existence of any of the following circumstances:

(a) Malfeasance, misfeasance or fraud on the part of Minnesota Mutual.

(b) Failure by Minnesota Mutual to perform any provision of this contract, subject to Minnesota Mutual having 90 days to cure any failure of contract performance.

(c) A material change in Minnesota Mutual's financial position, defined as the occurrence of two or more of the following:

- Minnesota Mutual's Standard & Poor's rating falls to A+ or lower.
- Minnesota Mutual's Moody's rating falls to A3 or lower.
- Minnesota Mutual's Duff & Phelps rating falls to A+ or lower
- Minnesota Mutual's A.M. Best rating falls to A- or lower.

However, in the event of any drop in ratings that is a result of a recalibration of the life insurance industry by any of the aforementioned rating agencies Minnesota Mutual and the Contract Owner will use their best efforts to amend this provision consistent with any such recalibration.

Minnesota Mutual may terminate this contract as of a date specified by written notice to the Contract Owner in the event that:

(a) The contract is no longer part of a Plan qualified under Section 457, or other provision of the Internal Revenue Code allowing similar tax treatment; or

(b) Minnesota Mutual reasonably determines that it is necessary to amend or modify this contract to be consistent with law or regulation changes; or to ensure the financial soundness of the Contract; and the Contract Owner does not assent to the amendment or modification.

The contract will automatically be terminated in the event of termination of the Plan, as of the effective date of such termination.

## 7.03 EFFECT OF TERMINATION

After termination, no further purchase payments will be accepted by Minnesota Mutual under this contract.

Termination of the contract will have no effect on Participants as to whom Annuity Payments have commenced. As to other Participants, Participant Accumulation Values shall continue to be maintained under the contract until: (a) withdrawn to provide benefits under the conditions of Section 5.01; (b) applied to provide Annuity Payments; or (c) transferred to the Contract Owner as provided in Section 7.04 or Section 7.05. While Participant Accumulation Values are maintained under this contract, the withdrawal and transfer provisions will continue to apply on the same basis as prior to termination.

If the Participant Accumulation Values are to be transferred to the Contract Owner, Minnesota Mutual shall determine a liquidation date which shall be a Valuation Date not later than 180 days after the date of termination.

## 7.04 LUMP SUM TERMINATION VALUE

The lump sum termination value will be equal to the sum of all Participant's Separate Account Accumulation Values plus the lesser of:

a) The sum of all Participant's General Account Accumulation Values; or

b) The sum of all Participant's General Account Market Values.

A market value will be determined in aggregate for Participant General Account Accumulation Values based on the following formula:

$$\text{Market value} = (\text{Participant General Account Accumulation Value}) \times \frac{(1 + G)^6}{(1 + C + .0025)^6}$$

where G = the greater of:

(a) the weighted interest crediting rate in effect on all Participant General Account Accumulation Values under this contract as of the liquidation date; or

(b) the weighted interest crediting rate in effect on all Participant General Account Accumulation Values at any time during the six month period preceding the liquidation date.

C = the lesser of:

(a) the current interest crediting rate in effect for new purchase payments to this contract as of the liquidation date; or

(b) the interest crediting rate in effect for new purchase payments to this contract as of six months prior to the liquidation date, adjusted by the interest yield on a 10 year U.S. Treasury note as of the liquidation date, less the yield six months prior to the liquidation date.

However, Minnesota Mutual guarantees that the Participant General Account Market Value will not be less than the sum of all allocations made to the General Account by or on behalf of each Participant, accumulated at 3% per annum, less any Participant withdrawals, any applicable deferred sales charge and less any transfers of General Account accumulation values to the Group Variable Annuity Account.

Within seven days after the termination of the contract, Minnesota Mutual will make payment to the Contract Owner of the Separate Account Accumulation Value held on behalf of each Participant. However, Minnesota Mutual reserves the right to defer payment for any period during which the New York Stock Exchange is closed for trading or when the Securities and Exchange Commission has determined that a state of emergency exists which may make such determination and payment impractical.

Minnesota Mutual will make payment to the Contract Owner of the General Account portion of the lump sum termination value on the liquidation date.

## 7.05 INSTALLMENT TERMINATION VALUE

Under the installment method of liquidation, Minnesota Mutual will make payment to the Contract Owner of the Separate Account Accumulation Value held on behalf of each Participant within seven days following the termination of the contract. However, Minnesota Mutual reserves the right to defer payment for any period during which the New York Stock Exchange is closed for trading or when the Securities and Exchange Commission has determined that a state of emergency exists which may make such determination and payment impractical.

The General Account portion of each Participant's Accumulation Value will be paid to the Contract Owner in substantially equal installments over a five year period. The Contract Owner may elect annual or quarterly installments with the first installment due as of the liquidation date and the last installment due at the end of the five year period. The amount of each installment will be determined by dividing the total Participant General Account

Accumulation Values as of each installment date by the number of remaining installments including the installment which is being calculated. During the installment period, Participant General Account Accumulation Values will continue to earn interest at a rate determined by using the same methodology for determining such rate in effect immediately prior to termination. The gross yield on assets, before reduction for expense margin, assumed in employing the methodology will be determined in the same way as immediately prior to termination. This rate shall not be less than the hypothetical yield for a portfolio of five-year treasuries would be under the same historical cash flow for the General Account. The expense margin assumed in employing the methodology will be no greater than the expense margin used immediately prior to termination plus .25%.

**7.06 FINAL TERMINATION**

This contract shall finally terminate when each Participant's Accumulation Value is reduced to zero and Minnesota Mutual shall have completed all payments due hereunder.

## SECTION 8. GENERAL PROVISIONS

### 8.01 CONTRACT

This contract is delivered in, and shall be construed according to the laws of the jurisdiction specified on Page 1 hereof. With respect to all transactions regarding this contract, except as may be otherwise specifically provided, Minnesota Mutual may deal with the Contract Owner on the basis that the Contract Owner has full ownership and control of the contract. No obligation under the Plan is assumed by Minnesota Mutual, nor shall the Plan or any amendment thereto be construed to amend or modify this contract in any way except with the express written consent of Minnesota Mutual.

### 8.02 MODIFICATION OF CONTRACT

This contract may be modified at any time by written agreement between Minnesota Mutual and the Contract Owner. However, no such modification will adversely affect the rights of any Participant unless the modification is made to comply with a law or government regulation.

No person except the President, a Vice President, the Secretary, or an Assistant Secretary of Minnesota Mutual has authority on behalf of Minnesota Mutual to modify the contract or to waive any requirement of the contract. Minnesota Mutual shall not be bound by any promise or representation made by or to any agent or person other than as above.

### 8.03 BENEFICIARY

A Participant may designate a beneficiary to receive any amount which may become payable to such beneficiary under the terms of the Plan. The designation may be made or changed by the Participant at any time during his lifetime by filing satisfactory written notice with Minnesota Mutual at its Home Office. The new designation shall take effect only upon being recorded by Minnesota Mutual at its Home Office. When so recorded, even if the Participant is not then living, it shall take effect as of the date the notice was signed, subject to any payment made by Minnesota Mutual before recording the change.

The interest of any beneficiary who dies before the Participant shall terminate at the death of that beneficiary. If the interest of all designated beneficiaries has terminated, any proceeds payable at the Participant's death shall be paid to the Participant's estate.

### 8.04 PARTICIPATION IN DIVISIBLE SURPLUS

This is a participating contract. The portion, if any, of the divisible surplus of Minnesota Mutual accruing upon this contract shall be determined annually by Minnesota Mutual and shall be credited to the contract on such basis as is determined by Minnesota Mutual.

## 8.05 CERTIFICATES AND STATEMENTS

Minnesota Mutual shall make available to each Participant a certificate which describes the Participant's rights and privileges under this contract. Minnesota Mutual shall issue to each Participant as to whom Annuity Payments are provided hereunder an individual certificate setting forth the amount and terms of such Annuity Payments. At least once in each Contract Year, Minnesota Mutual will furnish to the Participant a statement of each Participant's Individual Account, the current accumulation unit value, and each Participant's Accumulation Value. Such statement shall be as of a date within two months of the mailing of the statement.

## 8.06 MISSTATEMENT OF AGE

If a person's age has been misstated, the amount payable under this contract as an annuity will be that amount which would have been paid based upon that person's correct age. In the case of an overpayment, Minnesota Mutual may either deduct the required amount from that person's future annuity payments under this contract; or, require the person to pay Minnesota Mutual in cash; or both may be done until Minnesota Mutual has been fully repaid. In the case of an underpayment, Minnesota Mutual will pay the required amount with the next payment.

## 8.07 ASSIGNMENT

The Participant's Accumulation Value may not be assigned, sold, transferred, discounted or pledged by the Participant as collateral for a loan or as security for the performance of an obligation or for any other purpose. To the maximum extent permitted by law, the Participant's Accumulation Value and any benefits payable under this contract shall be exempt from the claims of creditors of the Participant.

## 8.08 CONTRACT VALUES

Amounts payable at death, withdrawal benefits, Accumulation Values and the annuity benefit described in this contract are not less than the minimum benefits required by any statute of the state in which this contract is delivered.

## 8.09 ANNUITY RESERVES

Reserves held by Minnesota Mutual for Annuity Payments under this contract shall not be less than those reserves required by the law in the state in which this contract is delivered.

# DEFERRED COMPENSATION PLAN BUSINESS AGREEMENT

This Agreement is entered into by and between the Minnesota State Board of Investment (hereinafter the "SBI"), the Minnesota State Retirement System (hereinafter the "MSRS") and The Minnesota Mutual Life Insurance Company (hereinafter "Minnesota Mutual"), this first day of July, 1994 (hereinafter the "Effective Date"), to amend and supplement Group Deferred Variable Annuity Contract Number 0844049.

The SBI, the MSRS and Minnesota Mutual, in consideration of the mutual agreements contained herein, do hereby agree as follows:

## I. DEFINITIONS

A. The Plan - The "Plan" as defined in Section 1.01 of Group Deferred Variable Annuity Contract Number 0844049.

B. The Prior Contracts - Collectively, Group Deferred Annuity Contract Number 0844047, issued by Minnesota Mutual and Northwestern National Life Insurance Company (individually, the "Prior Fixed Contract") and Group Accumulation Annuity Contract Number 0844048, issued by Minnesota Mutual (individually, the "Prior Variable Contract"), which Prior Contracts where issued for the purpose of underwriting certain of the fixed and variable annuity options under the Plan.

C. The New Contract - A new Group Deferred Variable Annuity Contract (Number 0844049) developed and issued by Minnesota Mutual and offering both fixed and variable options for use in connection with the Plan.

D. MSRS - The Minnesota State Retirement System, which, acting through its executive director with the advice and consent of its board of directors, administers the Plan.

E. Product Provider(s) - A life insurance company appointed by the SBI which offers annuity contracts to be used in conjunction with underwriting certain of the fixed and variable annuity options under the Plan.

F. Plan Marketing Organizations - Marketing Organizations which have entered into agreements with MSRS, which have been approved by the SBI, and pursuant to which such marketing organizations offer to participants in the Plan both the investment options managed by the SBI and the annuity contracts issued by the Product Providers.

G. Supplemental Investment Fund - The investment options available under the Plan which are managed by the SBI.

## II. APPOINTMENT OF MINNESOTA MUTUAL AS PRODUCT PROVIDER

The SBI hereby appoints Minnesota Mutual as a Product Provider to the Plan for the purpose of making available to the participants in the Plan the New Contract and the options available thereunder, and Minnesota Mutual hereby accepts such appointment subject to the terms and conditions set forth herein. In the performance of its responsibilities under this Agreement, the relationship of Minnesota Mutual to the SBI and/or MSRS is solely that of an independent contractor. Nothing contained herein shall be construed as establishing an employment, joint venture or partnership relationship between Minnesota Mutual and the SBI and/or MSRS. Minnesota Mutual's obligations and the relationship between Minnesota Mutual and the SBI shall be governed solely by the terms of this Agreement, the Prior Contracts and the New Contract. SBI also acknowledges that Minnesota Mutual shall have no responsibility for the establishment or operation of the Plan, except as provided by the terms of this Agreement.

## III. CLOSING OF THE PRIOR CONTRACTS

A. Closing Date

Except as otherwise provided in this Section III, the Prior Contracts shall be closed with respect to the Plan beginning on the later of the Effective Date or the date on which the registration statement covering the New Contract is declared effective by the United States Securities and Exchange Commission, but in no event later than September 30, 1994, or such later date as may be agreed to by the SBI (the "Closing Date"). On and after the Closing Date all salary deferrals and/or purchase payments allocated to the general account of Minnesota Mutual shall be credited to the general account under the New Contract rather than the Prior Fixed Contract. With regard to salary deferrals and/or purchase payments which are being allocated to a separate account of Minnesota Mutual under the Prior Variable Contract, such salary deferrals and/or purchase payments shall continue to be allocated to the Prior Variable Contract for up to 90 days after the Closing Date or until such earlier date as Plan participants have provided new purchase payment allocation instructions to Minnesota Mutual for use in connection with the New Contract. Beginning 90 days after the Closing Date, or such later date as Minnesota Mutual may determine, all salary deferrals and/or purchase payments allocated to a separate account shall be credited to the New Contract.

B. Accumulation Values In Prior Contracts

Accumulation values in the Prior Contracts on and after the Closing Date shall continue to be subject to and controlled by the terms and provisions set forth in the Prior Contracts, and by the provisions of the Plan and the rules thereunder.

Accumulation values in the Prior Variable Contract may be left therein and may be transferred between the various sub-accounts available thereunder. Such accumulation values may also be transferred, without restriction, to any other investment option available under the Plan, including the New Contract, or withdrawn or annuitized subject to rules and restrictions under the Plan and the Prior Variable Contract. Accumulation values in the Prior Fixed Contract may also remain in such contract until withdrawn or transferred to another investment option under the Plan, including options under the New Contract. Any provision in the Prior Fixed Contract not withstanding, accumulation values remaining in the Prior Fixed Contract after the Closing Date shall be subject to the same portability rights and restrictions as general account accumulation values held under the New Contract (see Paragraph C of Section IV of this Agreement); provided, however, during the six-month period beginning on the Closing Date, a Plan participant may transfer all or any portion of such accumulation values, without restriction, to any other variable investment option available under the New Contract.

## IV. THE NEW CONTRACT

A. Generally; Availability

The form of the New Contract has been provided to and approved by the SBI. The terms and conditions of the New Contract are incorporated herein by reference and made a part of this Agreement except as otherwise provided.

The New Contract shall be available for use in connection with the Plan on the Effective Date of this Agreement or as soon thereafter as the registration statement covering the New Contract shall have been declared effective by the United States Securities and Exchange Commission, but in no event later than September 30, 1994, or such later date as may be approved by the SBI. Salary deferrals and/or purchase payments received prior to such date shall continue to be allocated to the Prior Contracts.

B. Allocations Options

The New Contract will offer one general account or fixed annuity option.

The New Contract will also provide, with respect to purchase payments allocated to a separate account of Minnesota Mutual and its various sub-accounts, variable investment funds in which such purchase payments may be invested. The investment funds available to the New Contract's sub-accounts shall be as follows:

1. Money Market Portfolio of MIMLIC Series Fund, Inc.

2. Index 500 Portfolio of MIMLIC Series Fund, Inc.

3. Vanguard/Wellington Fund, Inc.

4. Long-Term Corporate Portfolio of Vanguard Fixed Income Securities Fund, Inc.

5. Scudder International Fund, a series of Scudder International Fund, Inc.

6. Fidelity Contrafund

7. Janus Twenty Fund, a series of the Janus Investment Fund

The continued use of these investment funds is contingent upon their availability for purchase by Minnesota Mutual and the sub-accounts of its separate account. Substitute or additional investment funds may be made available under the New Contract only with the consent of the SBI.

C. Provisions Of New Contract Amended By This Agreement

(1) Portability

Transfers of accumulation values held in the general account and the separate account shall be permitted in accordance with the provisions of the New Contract; provided, Section 5 and any other provision in the New Contract notwithstanding, Plan participants may annually, in each calendar year, transfer up to 20% of accumulation values held in the general account and may also transfer 100% of such accumulation values at termination of employment or at retirement.

(2) Deferred Sales Charge

The deferred sales charge described in Sections 3.01 and 5 of the New Contract shall not apply to the Plan or its participants, nor shall it apply to any withdrawals or transfers described in such sections of the New Contract.

(3) Termination

Section 7.02 of the New Contract is amended to provide that the New Contract shall also terminate:

(i) in the event that Minnesota Mutual fails to comply with or perform any provision of this Agreement, subject to Minnesota Mutual's right to cure such failure within 90 days after receipt of written notice thereof; and

(ii) on June 30, 1999 or upon the earlier termination of this Agreement.

D. Interest Rates And Expenses

The minimum rate of interest credited to accumulation values in the general account, as well as all expenses applicable to the general and separate accounts, shall be as set forth in the New Contract. Minnesota Mutual agrees that it will not report rates of return on general or separate account accumulation values to Plan participants except on a basis which takes into account all applicable expense factors. Minnesota Mutual agrees to provide 30 days notice of any change in separate account expense factors.

## V. DUTIES OF MINNESOTA MUTUAL

A. Minnesota Mutual shall accept purchase payments allocated to the New Contract in connection with the Plan in whatever frequency they are transmitted. Minnesota Mutual shall apply such purchase payments to the appropriate New Contract participant's accumulation value in accordance with the instructions received from the appropriate employer directing the amount of purchase payment to be applied to each participant account. Purchase payments shall be credited to a New Contract participant's accumulation value in accordance with the terms of the New Contract upon receipt of such purchase payments by Minnesota Mutual at its home office with appropriate allocation instructions.

B. When making any benefit payments in accordance with the Plan, Minnesota Mutual shall report to the Internal Revenue Service the amounts of such payments in accordance with Internal Revenue Service requirements.

C. Minnesota Mutual agrees to withhold federal and state income taxes from benefit payments in accordance with instructions from the Plan participant's employer as to the amounts to be withheld, or as is otherwise required by the Internal Revenue Service or by appropriate state tax authorities.

D. Minnesota Mutual agrees that, with respect to matters relating to the Plan, Minnesota Mutual will make information from its participant account records available to the SBI, MSRS and the Plan Marketing Organizations upon request. Minnesota Mutual shall provide, at its expense, software to allow the Plan Marketing Organizations and MSRS access to Minnesota Mutual's system of Plan participant information relating to the Prior Contracts and the New Contract. Minnesota Mutual also agrees that Plan participant records are private and that only Minnesota Mutual, the SBI, MSRS, and the Plan Marketing Organizations where necessary, shall have access to such records.

E. Minnesota Mutual agrees to comply in all areas with:

1. Rules of the Plan which have been approved by the SBI, to the extent required by Minnesota Statutes, §352.96, subd. 3 (1993 Supp.), and filed with the Minnesota Secretary of State and Revisor of Statutes;

2. Minnesota Statutes 1992, § 352.96 (1992 and 1993 Supp.), and any amendments thereto, provided such amendments do not impair a material provision of the New Contract and this Agreement; and

3. §457 of the Internal Revenue Code of 1986, as amended, or any rules and regulations thereunder.

## VI. MARKETING AND ADMINISTRATIVE SERVICES

A. Plan Marketing Organizations

Minnesota Mutual understands and agrees that MSRS may enter into separate agreements with Plan Marketing Organizations which will enroll and provide service to participants in the Plan. Subject to the approval of the SBI, MSRS, not Minnesota Mutual, is responsible for hiring, directing and supervising, terminating, and determining the compensation or other emoluments payable to these Plan Marketing Organizations. Minnesota Mutual agrees that, except as provided in this Agreement, it will not provide any compensation or other emoluments to any Plan Marketing Organization, or to any individual agent employed by a Plan Marketing Organization, in connection with services provided to the Plan unless such compensation or emolument has been approved by MSRS and the SBI.

B. Cooperation With Plan Marketing Organizations

Minnesota Mutual (and its broker-dealer affiliate) agrees to make the New Contract available to the Plan Marketing Organizations for offer to Plan participants. In that regard, Minnesota Mutual (and its broker-dealer affiliate) will enter into such selling agreements as are necessary to make the New Contract available to the Plan Marketing Organizations and will also appoint as its agents such employees of the Plan Marketing Organizations as are necessary. Nothing in this Agreement or in any agreement between MSRS and a Plan Marketing Organization shall preclude or limit Minnesota Mutual, or its broker-dealer affiliate, from exercising its rights, duties or obligations under any law or regulation to supervise the offer and sale of the New Contract and the persons or individuals it has authorized or appointed to offer and sell the New Contract. Failure to cooperate with Plan Marketing Organizations, subject to Minnesota Mutual's right to cure such failure within 90 days after receipt of written notice thereof, is grounds for termination under both Section IX of this Agreement and Section 7.02 of the New Contract.

C. Equality Of Presentation

MSRS shall have sole responsibility for ensuring that the Plan Marketing Organizations provide fair and equal presentations of all investment options available under the Plan and that the compensation and emoluments paid to the Plan Marketing Organizations represents the entire compensation and emoluments received by any Plan Marketing Organization with regard to the Plan. Upon request by Minnesota Mutual, SBI shall request MSRS to provide reasonable assurances to Minnesota Mutual that such fair and equal presentations are being made. The Agreements with the different Plan Marketing Organizations shall be substantially identical in form and content and the requirements of the MSRS shall be consistently applied to all Plan Marketing Organizations.

Disputes, if any, between the Product Providers, SBI and/or MSRS over the presentation of products or rates of return and materials prepared by the Plan Marketing Organizations shall be resolved by a Plan consultant retained by the SBI. Costs of any such consultant shall be borne by the Product Provider or Providers initiating such dispute resolution process. Such costs shall not be counted as part of the $50,000 maximum applicable to monitoring costs which are to be reimbursed by Minnesota Mutual in accordance with Section VII of this Agreement.

D. Reimbursement To MSRS

Minnesota Mutual agrees to make payments to MSRS to reimburse it for administrative services provided in connection with the Plan. At the end of each calendar month, Minnesota Mutual will remit to MSRS in the first year a payment which is equal, on an annual basis, to .07% of the then current accumulation values (estimated monthly and reconciled to actual accumulation values quarterly) held under both the Prior Contracts and the New Contract. Accumulation values for this purpose shall not include amounts which have been applied to purchase any annuity option, but shall include amounts held for systematic withdrawal. In subsequent years the amount of this monthly payment, with respect to accumulation values under the Prior Contracts and the New Contract, may be adjusted from time to time by the SBI.

The SBI agrees that the percentage rate of reimbursement to MSRS for administration services shall be identical for the Product Providers.

E. Payments to Plan Marketing Organizations

Minnesota Mutual agrees to make payments monthly to each Plan Marketing Organization, or, where necessary, to the broker-dealer with which the employees of the Plan Marketing Organization are registered, for marketing services provided in connection with the Plan, which are equal, on an annual basis, to a percentage, which shall be the percentage rate set forth in Section 5 of the applicable agreements between MSRS and the Plan Marketing Organization, of the then current accumulation values held under both the Prior Contracts and the New Contract and attributable to the marketing efforts of such Plan Marketing Organization. Accumulation values for this purpose shall not include amounts which have been applied to purchase any annuity option, but shall include amounts held for systematic withdrawal.

Whenever accumulation values held under either the Prior Contracts or the New Contract are applied to provide any annuity option, which for this purpose shall not include amounts held for systematic withdrawal, Minnesota Mutual shall make a one-time payment to the Plan Marketing Organization to which such accumulation values are attributable, or, where necessary, to the broker-dealer with which the employees of the Plan Marketing Organization are registered, in an amount equal to 1.5% of the amount applied to provide such annuity option.

Any agreement between Minnesota Mutual and a Plan Marketing Organization, or a broker-dealer with which the employees of such Plan Marketing Organization are registered, with respect to such compensation or other emoluments shall be subject to prior approval by MSRS and the SBI. Minnesota Mutual shall not pay compensation or other emoluments to any Plan Marketing Organization or broker-dealer without first providing documentation of the amount and method of computation of such compensation or other emoluments to, and receiving approval from, MSRS. The SBI agrees that the percentage rate of compensation or other emoluments to Plan Marketing Organizations shall be identical for all Product Providers.

F. Costs Of Forms And Marketing Materials

The costs of developing and printing enrollment and/or application forms, beneficiary designation forms, transfer forms, brochures describing the Plan, products and investment options, brochures containing performance and risk comparison, or any other materials required in connection with the Plan shall be borne by the Product Providers and MSRS for the Supplemental Investment Fund. The percentage of such costs which the Product Providers shall bear shall be equal to the percentage of total assets then held under the Plan by such Product Provider.

Minnesota Mutual agrees to provide developmental and printing services to MSRS to the extent permitted by law, subject to control by MSRS, in connection with such forms, brochures and materials. If such services are provided by Minnesota Mutual, the cost of such services shall be subject to verification by MSRS and billed directly to MSRS by Minnesota Mutual and then re-billed by MSRS to the Product Providers and MSRS.

## VII. REIMBURSEMENT FOR MONITORING COSTS

Minnesota Mutual agrees to make payments to the SBI to reimburse the SBI for Minnesota Mutual's share of the SBI's costs in monitoring the performance of the investment options under the Plan. The SBI agrees to provide to Minnesota Mutual a statement of its monitoring costs, in reasonable detail, prior to the making of such payment by Minnesota Mutual. The portion of such costs due hereunder in any year from Minnesota Mutual shall be determined by dividing the total of such costs by the number of Product Providers. In no event, however, shall the total amount of all reimbursement payments by Minnesota Mutual under this Section VII exceed $50,000 during the term of this Agreement, without the prior consent of Minnesota Mutual. Payments shall be made on an invoice from the SBI. The invoice schedule will be determined by the SBI but Minnesota Mutual shall not receive an invoice more frequently than quarterly. Payments are due 30 days from the date of receipt by Minnesota Mutual of the invoice.

## VIII. AUDIT OF MINNESOTA MUTUAL

Minnesota Mutual agrees to provide annually to the SBI a copy of its financial statements which shall have been examined and certified by independent auditors. In addition, Minnesota Mutual agrees to allow such of its books and records and accounting procedures and practices as are directly relevant to the Plan and this Agreement to be examined in such manner as may reasonably be required by the SBI or the Legislative Auditor of the State of Minnesota.

## IX. TERMINATION OF AGREEMENT

This Agreement will terminate on June 30, 1999, unless terminated earlier hereunder. This Agreement will also terminate in the event the New Contract is terminated pursuant to Section 7.02 thereof, as amended by Section IV, paragraph C(3), of this Agreement.

## X. AMENDMENTS TO THIS AGREEMENT

No amendment to this Agreement shall be effective unless such amendment shall be in writing and signed by all of the parties hereto.

## XI. NOTICE

Any notice under this Agreement must be in writing and may be given by or on behalf of Minnesota Mutual by delivering the same to the SBI or by mailing it to the SBI at its address of record with Minnesota Mutual, and any notice to Minnesota Mutual given by the SBI shall be in writing and mailed to Minnesota Mutual at its Home Office. Any such notice shall be effective on the date of receipt unless the terms of this Agreement dictate otherwise.

## XII. GOVERNING LAW

This Agreement shall be construed according to the laws of Minnesota.

## XIII. INDEMNIFICATION AND DEFENSE

Minnesota Mutual hereby agrees to indemnify and hold harmless the State of Minnesota, the Minnesota State Board of Investment (in this section, the "Board"), each member of the Board individually, the officers, agents and employees of each and every of the above, their successors, and any combination thereof, from all claims, demands, or causes of action arising out of an act or omission of Minnesota Mutual related to this Agreement or an act or omission of Minnesota Mutual related to Minnesota Mutual's sales activities in connection with the Plan; provided, however, that such acts or omissions of Minnesota Mutual shall not include acts or omissions of Plan Marketing Organizations related to sales activities in connection with the Plan where the MSRS has directed or assumed responsibility for the supervision of such sales activities as described in Section VII of this Agreement.

Minnesota Mutual shall reimburse the Board for all reasonable expenses incurred to defend and legal proceedings that may be brought against the State of Minnesota, the Minnesota State Board of Investment, each member of the Board individually, the officers, agents and employees of each and every of the above, their successors, and any combination thereof, on any claim or demand effected by this section, and shall satisfy any judgment that may be rendered against such party or parties in respect to any such claim or demand. The Board shall notify Minnesota Mutual upon receipt of any such claim or demand which it receives. Pursuant to Minnesota Statutes section 8.06, the Minnesota Attorney General (or its designee) shall be the legal counsel for the State of Minnesota, the Board, the members of the Board individually, and the officers, agents and employees of the Board or the State of Minnesota.

## XIV. EMPLOYMENT PRACTICES

Minnesota Mutual certifies that it has received a certificate of compliance from the Commissioner of Human Rights pursuant to Minnesota Statutes section 363.073.

## XV. DATA CONFIDENTIALITY

To the extent that Minnesota Mutual has access to data of the Plan which is classified as private, nonpublic or confidential pursuant to the Minnesota Government Data Practices Act, Minnesota Statutes chapter 13, Minnesota Mutual agrees to comply with the requirements of Minnesota Statutes chapter 13 in providing services under this Agreement. Minnesota Mutual agrees to indemnify, save and hold harmless the State of Minnesota, the Minnesota State Board of Investment, each member of the Board individually, the officers, agents and employees of each and every of the above, from all claims arising out of, resulting from any act or omission of Minnesota Mutual or in any violation by Minnesota Mutual of any provision of the Minnesota Government Data Practices Act, Minnesota Statutes chapter 13, including legal fees and disbursements paid or incurred to enforce this provision of the Agreement. In the event Minnesota Mutual subcontracts any or all of the work to be performed under this Agreement, Minnesota Mutual shall retain responsibility under this paragraph for compliance with the Minnesota Government Data Practices Act.

## XVI. WAIVER

Any waiver at any time by either party hereto of any right with respect to any matter in connection with this Agreement shall not be deemed to be a waiver with respect to any subsequent matter.

## XVII. ANTITRUST

Minnesota Mutual shall assign to the State of Minnesota any and all claims for overcharges as to goods and/or services provided in connection with the Agreement resulting from antitrust violations which arise under the antitrust laws of the United States and the antitrust laws of the State of Minnesota.

## XVIII. SEVERABILITY

If any provision of this Agreement is held invalid or unenforceable, such invalidity or enforceability will not affect the validity or enforceability of any provision hereof, all of which provisions are hereby declared severable.

## XIX. ONGOING OBLIGATION

The provisions of (1) Paragraphs B, C and D of Section IV, (2) Paragraphs B, C, D and E of Section V, (3) Paragraphs D and E of Section VI, (4) Section VIII, (5) Section XIII and (6) Section XV herein shall survive any termination of this Agreement; provided, however, that the provisions of Paragraphs D and E of Section VI shall not survive a termination of this Agreement prior to June 30, 1999.

IN WITNESS WHEREOF, the parties have, by their duly authorized officers or representatives, executed five (5) counterparts of the Agreement, intending to be bound thereby.

**MINNESOTA STATE BOARD OF INVESTMENT**

By: ______________________________

Title: ______________________________

**MINNESOTA STATE RETIREMENT SYSTEM**

By: ______________________________
Executive Director

**THE MINNESOTA MUTUAL LIFE INSURANCE COMPANY**

By: ______________________________

Title: ______________________________

By: ______________________________

Title: ______________________________

**STATE OF MINNESOTA**
**THE OFFICE OF THE ATTORNEY GENERAL**

By: ______________________________
Assistant Attorney General

**STATE OF MINNESOTA**
**DEPARTMENT OF ADMINISTRATION**

By: ______________________________

Title: ______________________________

**STATE OF MINNESOTA**
**DEPARTMENT OF FINANCE**

By: ______________________________

Title: ______________________________

# Service Agreement with National Benefits

**MARKETING AND SERVICE AGREEMENT**
**Minnesota State Deferred Compensation Plan**

This Marketing and Service Agreement ("Agreement") is entered into by and between the State of Minnesota ("State"), acting through the Minnesota State Retirement System Board ("Board") on behalf of the Minnesota State Deferred Compensation Plan ("Plan"), and National Benefits, Inc. ("NBI"), a Minnesota Corporation, a deferred compensation plan service organization.

**WHEREAS**, the State has established an eligible Deferred Compensation Plan pursuant to Section 457 of the Internal Revenue Code and Minn. Stat. § 352.96 for the benefit of its employees and employees of the political subdivisions of the State; and

**WHEREAS**, the Executive Director of the Minnesota State Retirement System with the advice and consent of the Board of Directors must administer the Plan; and

**WHEREAS**, the Board desires assistance in enrollment, marketing, and service functions to operate the plan in accordance with the requirements of the Minnesota Statutes and Internal Revenue Code; and

**WHEREAS**, NBI represents itself to be experienced and qualified and capable of providing the necessary marketing and service functions for the operation of the Plan and has provided such functions for the Board in the past; and

**WHEREAS**, the Board desires to continue NBI as a marketing and service organization for the Plan and NBI desires to provide such services according to the terms of this Agreement;

**NOW, THEREFORE**, the parties to this Agreement agree as follows:

**ARTICLE 1**

**1. DEFINITIONS**

In this Agreement, the following terms shall be defined as set out in this Article.

1.1 **"Employer"** shall mean:

1) the State, or

2) a political subdivision of the State, or an agency or instrumentality of the State or its political subdivisions.

1.2 "**Employee**" shall mean an employee eligible for participation in the plan under § 352.96.

1.3 "**Plan**" shall mean the State of Minnesota Deferred Compensation Plan created under Minn. Stat. § 352.96.

1.4 "**Assigned Client Service Units**" shall mean the governmental units for which NBI agrees to perform marketing and other required services under this contract designated for NBI in the attached Exhibit A, the terms of which are incorporated herein. Any changes in assigned client service units shall only be made upon mutual agreement by the participating service organizations and the Executive Director. Upon termination of this agreement, Exhibit A is null and void.

1.5 "**Eligible Employees**" shall mean the employees in the assigned client service units assigned by the Executive Director of the Minnesota State Retirement System.

1.6 "**Board**" shall mean the Board of Directors of the Minnesota State Retirement System.

1.7 "**Executive Director**" shall mean the Executive Director of the Minnesota State Retirement System.

1.8 "**Required Services**" shall mean the detailed listing of required services in the document entitled "Required Services" attached to this Agreement as Exhibit B.

1.9 "**Investment Product**" shall mean an investment option approved by the State Board of Investment for offering to Plan participants and provided by product provider.

1.10 **"Product Provider"** shall mean any company that has a contract with the State Board of Investment to offer an investment product under the Plan or the State of Minnesota Supplemental Fund.

1.11 "**Non-annuitized Assets**" shall mean accumulation values less amounts which have been applied to purchase any annuity option. Amounts held for systematic withdrawal will be included as non-annuitized assets.

## ARTICLE 2

## 2. GENERAL TERMS AND PROVISIONS

2.1 **Appointment.** The Board authorizes and appoints NBI to service and market the Plan for the term of this Agreement.

2.2 **Effective Date and Term of the Agreement.** NBI shall service and market the Plan commencing on September 1, 1994 and ending on June 30, 1999, unless this Agreement is terminated earlier in accordance with Article 8 of the Agreement.

2.3 **Execution of the Agreement.** This Agreement becomes binding upon the Board and NBI when it is reviewed and approved by the Board or its representative and the State Board of Investment pursuant to Minn. Stat. § 352.96 and signed by authorized representatives for each party. By their signatures, the parties' representatives represent that they have legal authority to sign and bind their principals and that each party has all required legal right and power to perform all acts called for by this Agreement in the State of Minnesota and elsewhere.

2.4 **Governing Law and Forum Selection.** This Agreement is entered into in the State of Minnesota and shall be construed and interpreted in accordance with its laws. In the event any dispute arises under this Agreement which the parties cannot resolve by mutual consent, such dispute, including responsibility for the cost of resolving the dispute, shall be resolved and determined through mediation or binding arbitration under the rules of the American Arbitration Association.

## ARTICLE 3

## 3. NBI'S MARKETING AND SERVICE RESPONSIBILITIES

3.1 **Administrative Duties and Services.** NBI is responsible for educating eligible employees regarding all aspects of the Plan and the effect of their participation in the Plan. The information which NBI presents to eligible employees shall be factual and clearly presented and shall fully disclose all costs, rates of return, transfer rights, and plan features, both positive and negative, so as to enable all eligible employees to determine whether they wish to participate in the Plan and the extent of any participation. NBI's marketing and service duties shall include, but are not limited to the list of required services attached as Exhibit B. Additional duties may be assigned and current duties altered upon request by the Executive Director, based upon reasonable change in needs and circumstances, provided these do not result in substantial changes in cost to NBI.

3.2 **Only Approved Investment Products and Exclusive Marketing Agreement.** NBI shall not solicit business from any eligible employee for any other Section 457 Deferred Compensation Plan in Minnesota. Further, NBI shall abide by the same rules that each employer has established regarding the contacting of employees for any other type of business or services, including, but not limited to, marketing tax sheltered annuities under Section 403B. If NBI is making a presentation or conducting a meeting as a representative of the Plan, only general information about any other type of business or service agreement can be discussed. Specific products offered through any other type of business or service agreement cannot be discussed while serving as a representative of the Plan without prior written approval from the employer.

3.3 **Representatives and Licensing.** NBI will employ an adequate number of marketing and service representatives to provide the required services to all eligible employees regarding all aspects of the Plan, and shall maintain adequate continuing service to all eligible employees

NBI is responsible for obtaining and maintaining all licensing required by any local, state, or federal agencies and any product providers for all NBI employees engaged in marketing or servicing employees in the Plan. Any employee of NBI who does not have all necessary licensure shall not be permitted to solicit any employee for enrollment in the Plan. NBI shall also obtain and maintain all required local, state, and federal licenses, permits, and franchises necessary to carry out its responsibilities under this Agreement. NBI agrees that its directors, officers, agents, and employees shall not receive or handle any funds deferred by participants under the Plan except as provided in this Agreement. NBI further agrees to report the names and license numbers of its representatives to the Executive Director and that none of its representatives will be permitted to market and service the Plan unless the representatives' names and license numbers have been submitted in writing to the Executive Director.

If, at any time, the Board believes that an NBI representative is not satisfactorily complying with the provisions of this Agreement as to the marketing and servicing of the Plan Participants, it shall notify NBI in writing of the reason for this dissatisfaction. If, after 30 days following the Board's written notice, the Board believes that the situation has not been corrected to its satisfaction, NBI shall agree to withdraw its representative from the Plan. The Board also has the right to require immediate withdrawal if the

Board determines that a representative is involved in misrepresentation of investment products or rules or other fraudulent or criminal activity. Prior to requiring withdrawal of a representative, the Board shall provide the representative and NBI with reasonable notice of its proposed action and an opportunity to be heard before the Board.

3.4 **Representative Compensation.** NBI shall not compensate its representatives in any manner that would promote participant investment in a particular investment product.

NBI shall represent and market all investment products offered under the Plan in an equal and unbiased manner and shall provide the Board with the compensation plan or formula used to pay its representatives and staff.

3.5 **Marketing Materials and Forms.** Prior to distribution or presentation to eligible employees and employers, NBI will prepare and submit to the Executive Director for approval drafts of all literature, forms, newsletters, video presentations, and scripts or outlines of oral presentations regarding the Plan to be provided to employees and payroll personnel. The data contained in all such marketing literature and other written visual aids prepared by NBI for use with the Plan shall at all times be the property of the State, and NBI shall not obtain or reserve any proprietary or literary rights with respect to any such data. Upon request of the Board, NBI shall execute any assignments or releases necessary to convey any proprietary rights it may have to the State. Only material and forms approved by the Executive Director may be made available to eligible employees and employers.

NBI shall not represent itself to eligible employees as qualified financial planners and shall provide only general financial advice which has been approved by the Executive Director.

The product providers shall be responsible for the costs associated with the printing of a reasonable number of the materials as listed in the Deferred Compensation Plan business agreement. All other printing costs and mailing costs shall be the responsibility of NBI. The product providers shall be responsible for all expenses associated with the connection of NBI'S data transmissions and product providers computers.

3.6 **Employee Meetings.** NBI agrees to conduct employee meetings, with the permission of the employer, during work hours at employee work stations. No such contacts are to be made by any representative of NBI unless they are scheduled in advance and the employer has made arrangements for the representative to meet with eligible employees. No contacts are to be made at an employee's residence unless requested by the employee. A representative may not suggest a meeting at an employee's residence.

NBI agrees to provide prior notice to the Executive Director of any group presentations and group meetings. Requests for follow-up meetings must be approved by the employer.

3.7 **Reports to the Executive Director.** NBI shall furnish to the Executive Director each month a report describing the level of enrollment and participation in the Plan as requested by the Executive Director. The monthly report shall also list by employer the date of any employee group meetings.

NBI also agrees to provide the Executive Director with information and reports as may be reasonably required by the Board or the Executive Director to enable them to carry out their responsibilities

3.8 **Employee Complaint Procedure.** NBI will respond to all participant complaints within five work days and, whenever reasonably possible, resolve complaints relating to their responsibility within five additional work days. NBI will submit monthly reports to the Executive Director listing the written complaints received along with the status, and any resolutions, of the complaints. All written complaints and written responses will be submitted along with the monthly report. Any complaints not resolved between the complainant and NBI may be submitted to the Executive Director who shall resolve the dispute through the issuance of a written decision. Either party may request Board review of the Executive Director's determination, and the Board's decision shall be final.

## ARTICLE 4

## 4. RESPONSIBILITIES OF THE BOARD AND EXECUTIVE DIRECTOR

4.1 **Maintenance of Eligible Plan.** The Board shall maintain the Plan as an "eligible deferred compensation plan" within the meaning of Section 457 of the Internal Revenue Code.

4.2 **Approval of Investment Contractors.** The State Board of Investment shall designate those investment contracts that are approved for use in the Plan.

4.3 **Necessary Approvals.** The Board or its Executive Director shall provide timely information and approvals as are reasonably required by NBI for the maintenance, operation, and communication of the Plan.

4.4 **Operating Decisions.** The Board or its Executive Director shall be responsible for making, to the extent not otherwise delegated, all decisions necessary for the operation of the Plan, including, without limitation, decisions authorizing or denying early withdrawals in the event of an unforeseeable financial emergency in accordance with the Plan.

4.5 **Review.** The Executive Director will conduct at least semi-annual reviews with NBI to insure compliance with the terms of this Agreement. The product providers will be invited to attend the reviews or submit any comments in writing to be included as part of the reviews. The Executive Director will summarize the reviews in writing. NBI can provide written comments within one week after the review to be attached to the written reviews.

**ARTICLE 5**

**5. COMPENSATION TO NBI**

5.1 **Compensation.** NBI shall receive compensation for performing its required services based on the following formula:

| Period | Annual Basis Points (paid on total non-annuitized assets for eligible employees in assigned client service units) |
|---|---|
| September 1, 1994 to June 30, 1995 | 33 |
| July 1, 1995 to June 30, 1996 | 31 |
| July 1, 1996 to June 30, 1997 | 30 |
| July 1, 1997 to June 30, 1998 | 29 |
| July 1, 1998 to June 30, 1999 | 28 |

NBI will receive 1/12th of the annual basis point amount each month based on the non-annuitized assets in their assigned client service unit at the end of each month.

In addition, a one-time 1 1/2% commission shall be paid to NBI the month following commencement of annuitization occurring during the term of this Agreement for eligible employees in NBI's assigned client service unit. NBI shall also receive the commission for annuity applications received prior to termination of this agreement provided annuity payments commence within 60 days of termination of this agreement. Payment will be paid the month following commencement of the annuity.

The product providers shall provide NBI and the Executive Director the data and documentation necessary to confirm that NBI is being properly compensated.

NBI shall not be eligible for any further compensation following the termination of this Agreement and NBI waives all rights to future compensation from any product providers based upon services provided under this Agreement or any prior agreement.

5.2 **No Additional Compensation.** NBI shall not accept any additional compensation or emoluments other than the amounts described in Article 5.1 for services provided under this agreement. The acceptance of any additional compensation or emoluments by NBI from product providers shall be just cause for the termination of this Agreement.

Services rendered prior to the effective date of this contract by NBI under contract with a product provider are subject to the compensation terms of the previous contract. All compensation paid under a previous contract must be completed within six months of the effective date of this agreement and the amounts must be reported to the Executive Director.

5.3 **Method of Payment.** NBI shall be compensated under the terms of Article 5.1 on a monthly basis. Each product provider will pay the required basis points directly to the NBI within 20 days of month end. An estimated payment can be made to expedite payment to NBI as long as the exact amount due is balanced on at least a quarterly basis.

The product providers shall pay interest as specified in Minnesota Statutes § 334.01, subdivision 1 on the date of this agreement if payment is 30 or more days past due.

5.4 NBI shall sign any necessary agreements with the appropriate product provider to sell all approved investment products

## 6. RECORDS

6.1 **Books and Records are Property of the Board.** NBI shall maintain adequate records relating to participants, including but not limited to, participant correspondence, written notes of complaints registered by phone, beneficiary designations, tax withholding forms, and any forms relating to investment allocation and transfers, or withdrawal decisions for the duration of this Agreement. NBI may utilize microfilm or other similar medium approved by the Executive Director for this purpose

All data contained in books, records, documents, and other information relating to the Plan maintained by NBI shall at all times remain the property of the Board. Upon termination of this Agreement for any reason, NBI shall provide copies of all data and documents identified in the first paragraph of this article to the Executive Director within one month.

The parties recognize and agree that all books, records, documents and accounting procedures and practices of NBI relevant to the transactions and services provided under this agreement are subject to examination and audit pursuant to the provisions of Minn. Stat. § 16B.06, subd. 4.

6.2 **Confidentiality of Information.** Each party acknowledges that it may have access to information of a confidential nature, which information is the exclusive property of the other party.

Neither party will, without express written authorization from the other party, disclose any confidential information relating to the other party or relating to any of its controlled or affiliated corporations or organizations, or other related entities.

All records of the Plan shall be used only for the purposes of the Plan and shall be held confidential by NBI. This obligation shall continue upon expiration or termination of this Agreement. However, any records, reports, or other information relating to the Plan may be made available upon instructions by the Board, to any State authority or to any other person or entity.

## ARTICLE 7

## 7. INDEMNIFICATION AND INSURANCE

7.1 **Liability.** NBI agrees to indemnify and save and hold the State, its agents and employees harmless from any and all claims or causes of action arising from the performance of this contract by NBI or NBI's agents or employees. This clause shall not be construed to bar any legal remedies contractor may have for the state's failure to fulfill its obligations pursuant to this contract. Product providers or other marketing organizations shall not be contstrued as agents or employees of NBI.

7.2 **Insurance.** NBI shall maintain errors and omissions insurance covering its representatives in the amount of at least $100,000 per occurrence, relating to the services provided by NBI under this Agreement. NBI agrees to provide the Board with appropriate evidence of such insurance and promptly notify the Board of any lapse, cancellation, or expiration of any such insurance.

**ARTICLE 8**

## 8. TERMINATION

8.1 **Termination for Cause.** Neither party shall terminate this Agreement prior to its expiration date except for just cause. If either party elects to terminate the Agreement for just cause, thirty days written notice must be provided.

Reasons for termination for just cause include, but are not limited to:

1) Failure to comply with the obligations, requirements, or duties of this Agreement.

2) Misrepresentation of product, state law, federal law, or plan rules.

3) Providing financial or investment advice that is not approved by the Board or Executive Director.

4) Unequal representation of products.

5) NBI's acceptance of compensation or emoluments not provided for in Article 5.1.

6) Falsifying records.

7) If the intended purposes of this agreement are substantially altered or frustrated.

8.2 **Termination of Obligations.** Following the expiration or termination (as provided above) of this Agreement, NBI shall have no continuing obligation (except as otherwise expressly provided by this Agreement) with respect to any undertaking made in this Agreement.

8.3 **Return of Records.** At the expiration or termination of the Agreement, NBI will turn over all physical files and all required data pertaining to the plan in a reasonable format acceptable to the Board. NBI will return all files and data to the Board in a mutually agreeable time frame but in no case later than thirty days after the termination or expiration of the Agreement.

8.4 **Transfer of Ownership of NBI.** NBI shall not sell or transfer its business assets or the majority of its stock without the consent of the Board which consent shall not be unreasonably withheld. This provision shall not apply to transfers of NBI between or among family members of the existing owners, for which no consent is required.

## ARTICLE 9

## 9. MISCELLANEOUS

9.1 **Entire Agreement.** The parties agree that this Agreement contains the entire agreement between the parties with respect to the matters set forth and supersedes any prior agreements and negotiations between the parties. The parties further agree that any written contracts with product providers pertaining to the Minnesota State Deferred Compensation 457 Plan other than specified in Article 5.4 must be terminated by September 1, 1994. Proof of contract termination must be submitted to the Executive Director.

9.2 **Amendment.** The parties agree that any modifications to this Agreement must be in writing. Any changes in compensation as outlined in Article 5 must be signed by all other service organizations participating under the Plan and the Executive Director with Board approval.

9.3 **Headings.** The headings and numbering of parts of this Agreement are included solely for convenience of reference and shall not control or affect the meaning or interpretation of this Agreement.

9.4 **Execution by Counterparts.** Execution of separate copies of this Agreement by each of the parties shall have the same force and effect as though both parties had executed the original of this Agreement.

9.5 **Compliance with Applicable Laws.** NBI shall comply with all applicable federal, state and local laws in performing the services required under this Agreement, including but not limited to, applicable affirmative action requirements under state law, workers' compensation obligations under state law, and agrees that its books and records relating to its services hereunder are subject to examination by the Board and the legislative auditor.

9.6 **Subcontracts.** NBI shall not subcontract any of its responsibilities under this Agreement without the prior written approval of the Board except for nonadministrative duties other than record keeping.

9.7 **Affirmative Action.** If NBI employs more than twenty people, they will certify that they have received a certificate of compliance from the Commissioner of Human Rights pursuant to Minnesota Statutes § 363.073.

9.8 **Workers' Compensation.** In accordance with the provisions of Minnesota Statutes §176.182, the State affirms that NBI has provided acceptable evidence of compliance with the workers' compensation insurance coverage requirement of Minnesota Statutes § 176.181, subdivision 2.

MINNESOTA STATE
RETIREMENT SYSTEM

By:__________________________
DAVID BERGSTROM
Executive Director

Dated:__________________________

NATIONAL BENEFITS, INC.

By:__________________________
President

Dated:__________________________

Approved as to form and execution:

ATTORNEY GENERAL

By:__________________________
JON K. MURPHY
Assistant Attorney General

Dated:__________________________

COMMISSIONER OF ADMINISTRATION

By:__________________________

Dated:__________________________

COMMISSIONER OF FINANCE

By:__________________________

Dated:__________________________

**APPROVED:**

MINNESOTA STATE BOARD OF
INVESTMENT

By:__________________________
Howard Bicker
Executive Director

Dated:__________________________

Exhibit A

**MINNESOTA DEFERRED COMPENSATION CLIENT SERVICE UNITS
ASSIGNED TO THE MARKETING REPRESENTATIVES
OCHS SERVICES AND NATIONAL BENEFITS
BY THE MINNESOTA STATE RETIREMENT SYSTEM**

The units are split into one of the four following headings:

**<u>State Department</u>**

State employees

**<u>Minnesota Counties</u>**

Includes employees of the 87 Minnesota counties, also includes all employees of cities and other political subdivisions within each county.

<u>Exception</u>
Employees *not* included under the County heading are:

State employees
School District employees
Other miscellaneous employees

**<u>School District</u>**

Includes all School Districts within the State of Minnesota

*Does not* include State Universities, Community Colleges or State Schools.

**<u>Miscellaneous Units</u>**

Units that are exceptions to the three headings above.

# Minnesota Deferred Compensation

## Client Service Units

## Assigned to

## Ochs Services

## by

## The Minnesota State Retirement System

## OCHS SERVICES UNITS

State Departments

Administration
Administration and Finance - Zoological Garden
Agriculture
Ah-Gwah-Ching
American Legion
Animal Health
Anoka Regional Treatment Center
Arrowhead Community College
Arts School (Minnesota Center for Arts Education)
Assessors, Board of
Austin Community College
Bemidji State University
Board of Boxing
Board of Barber Examiners
Board of Electricity
Board of Arch., Engineering
Board of Accountancy
Brainerd Community College
Brainerd Regional Treatment Center
Cambridge Regional Treatment Center
Cambridge Center
Capitol Child Care Center
Clearwater Community College
Client Security Board
Commerce
Community College Board Office
Corrections
Council of Economic Status of Women
Council for Handicapped
Council on Vo Tech Education
Court of Appeals
Court Administrators (By County Allocation)
Dept. of Human Services - Central office
Disability Council
District Court Judges (By County Allocation)
Employee Relations

## OCHS SERVICES UNITS

State Departments

Faribault Regional Treatment Center
Fergus Falls Regional Treatment Center
Fergus Falls Community College
Gambling Control Board (including MN State Lottery)
Gillette Hospital
Governor's Manpower Office
Governor's Office
Governor's Appointments Committee
Governor's Residence Council
Hazardous Sub. Compensation Board
Hibbing Community College
Higher Education Facilities Authority
Horticultural Society
House of Representatives Staff
Inver Hills Community College
Iron Range Resources and Rehabilitation
Itasca Community College
Job Skills Board
Labor & Industry
Lakewood Community College
Law Enforcement Training Center
Lawyers Professional Responsibility Board
Legislative Reference
Legislative Commission on Employee Relations
Legislative Retirement Study Commission
Legislative Coordinating Commission
Legislative Audit Commission
Legislative Commission on Planning and Fiscal Policy
Legislative Commission to Review Administration
Legislature
Lieutenant Governor
Lino Lake Corrections
Mediation Services
Mesabi Community College
Minneapolis Community College
Minnesota Housing Finance
Minnesota State Retirement System

## OCHS SERVICES UNITS

State Departments

Minnesota Resources Commission
Minnesota Humanity Commission
Minnesota Safety Council
Minnesota Municipal Board
Moorhead State University
Moose Lake Regional Treatment Center
North Hennepin Community College
Northland Community College
Oak Park Heights Corrections
Oak Terrace Nursing Home
Office of Waste Management
Office of Administrative Hearings
Public Safety - State Patrol
Public Employees Retirement Association
Public Safety - Capitol Security
Public Safety - Licensing
Public Safety - Liquor Control
Public Safety - Administration
Public Safety - Emergency Services
Public Safety - Criminal Apprehension
Public Safety - Fire Safety
Rainy River Community College
Red Wing Corrections
Representatives
Rochester Community College
Sauk Centre Corrections
Senate Staff
Senators
Shakopee Corrections
Spanish Speaking Affairs Council
St. Cloud Corrections
St. Peter Regional Treatment Center
St. Cloud State University
State Planning Agency (Minnesota Planning Office)
State University Board
State Judges (By County Allocation)
State Fair
Stillwater Corrections

## OCHS SERVICES UNITS

State Departments

Teachers Retirement Association
Thistledew Camp
Trade & Economic Development, Department of
Vermilion Community College
Veterans of Foreign Wars
Veterans Affairs
Veterans Home
Water Resources Board
Willow River Camp
Willmar Regional Treatment Center
Willmar Community College
Winona State University
Workers Compensation Court of Appeals
Worthington Community College

## OCHS SERVICES UNITS

School Districts

Ada
Aitkin
Annandale
Appleton
Argyle
Atwater
Audubon
Badger
Battle Lake
Beardsley
Becker
Bellingham
Benson
Big Lake
Blackduck
Blue Earth
Borup
Braham
Breckenridge
Browns Valley
Cambridge-Isanti
Campbell-Tintah
Cass Lake
Chisago Lakes
Chokio-Alberta
Cold Spring
Cook County
Cosmos
Cyrus
Dassel-Cokato
Delavan
Detroit Lakes
Eden Valley
Elmore
Fergus Falls
Finlayson
Forest Lake
Franconia

## OCHS SERVICES UNITS

School Districts

Frazee
Fridley
Greenbush
Grove City
Grygla
Halstad-Hendrum
Hancock
Henning
Hinckley
Howard Lake
Inver Heights
Karlstad-Strandquist
Kelliher
Kennedy
Kenyon
Kerkhoven-Murdock-Sunburg
Kimball
Kittson Central
Lac Qui Parle Valley
Lake of the Woods
Lake Park
Lancaster
Laporte
LeSueur-Henderson
Madison-Marietta-Nassau
Mahtomedi
Maynard
Middle River
Milan
Minnewaska
Montevideo
Monticello
Montogomery
Morris
Moundsview
Nevis
New London-Spicer
Newfolden

**OCHS SERVICES UNITS**

School Districts

Norman County East
North St. Paul/Maplewood
North Branch
Oklee
Oslo
Parkers Prairie
Pelican Rapids
Perham
Pillager
Pine Point
Pine City
Pine River-Backus
Plummer
Prinsburg
Raymond
Red Wing
Red Lake
Remer
Roseau
Roseville
Rothsay
Rush City
Sebeka
South St. Paul
St. Paul
Stephen
Stillwater
Twin Valley
Underwood
United South Central
Wanamingo
Warren-Alvarado
Warroad
Waterville-Elysian-Morristown
Waubun
West St. Paul School
Wheaton
White Bear Lake

## OCHS SERVICES UNITS

Miscellaneous Departments

Cuyuna Range District Hospital (Crow Wing County)
Douglas County Hospital (Douglas County)
Granite Falls Municipal Hospital (Yellow Medicine County)
Greater Minnesota Corporation (Minnesota Technology Inc.)
Hutchinson Community Hospital (McLeod County)
Lakefield Municipal Hospital (Jackson County)
Metro Waste Control Commission
Metropolitan Council
Middle Management Association
Minnesota Association of Professional Employees
Northfield City Hospital (Rice County)
Worthington Regional Hospital (Nobles County)

If, at some time in the future, these units (any one or all) should again become eligible for the State Deferred Compensation Plan, they will revert back to their original assigned client service unit of Ochs Services. The units are:

Highway Credit Union
Minnesota Government Engineers Council
State Capitol Credit Union
State Employees Union

## OCHS SERVICES COUNTIES

Aitkin
Becker
Beltrami
Big Stone
Cass
Chippewa
Chisago
Cook
Dakota
Faribault
Goodhue
Hubbard
Isanti
Itasca
Kandiyohi
Kittson
Lac Qui Parle
Lake
Lake of the Woods
LeSueur
Mahnomen
Marshall
Meeker
Morrison
Nicollet
Norman
Ottertail
Pine
Pope
Ramsey
Red Lake
Roseau
Sherburne
Stearns
Stevens
Swift
Traverse
Wadena
Washington
Wilkin
Wright

# Minnesota Deferred Compensation

# Client Service Units

# Assigned to

# National Benefits

# by

# The Minnesota State Retirement System

## NATIONAL BENEFITS UNITS

State Departments

Amateur Sports Commission
Anoka-Ramsey Community College
Attorney General
Board of Psychology
Board of Optometry
Board of Nursing Home Administrators
Board of Veterinary Medicine
Board of Investment
Board of Social Work
Board of Marriage and Family Therapy
Board of Medical Examiners
Board of Unlicensed Mental Health Service
Board of Nursing
Board of Pharmacy
Board of Dentistry
Board of Chiropractors
Capitol Area Arch. and Planning Board
Continuing Legal Education Board
Department of Revenue
District Court Judges (By County Allocation)
DOT - Golden Valley
DOT - Rochester
DOT - Mankato
DOT - Willmar
DOT - Oakdale
DOT - Central Office
DOT - Duluth
DOT - Bemidji
DOT - Brainerd
DOT - Detroit Lakes
Economic Security
Education - Vo-Tech
Education
Education - Faribault
Education, State Board of
Employees Assistance Program
Ethical Practices Board
Finance

## NATIONAL BENEFITS UNITS

### State Departments

Full Productivity and Opportunity Office
Gaming Department - Racing Division
Health
Health Care Access Commission
Health Facilities Complaints, Office of
Higher Education Coordinating Board
Historical Society
Human Rights
Indian Affairs
Judicial Standards
Law Examiners
Law Library
Legislative Commission on Waste Management
Legislative Commission on Long Term Health Care
Legislative Commission on Public Education
Mankato State University
Metropolitan State University
Military Affairs
Minnesota Racing Commission
Natural Resources - Region 6
Natural Resources - Central Office
Natural Resources - Region 1
Natural Resources - Region 2
Natural Resources - Region 3
Natural Resources - Region 4
Natural Resources - Region 5
Normandale Community College
Office of Social Work and Mental Health
Office of Social Work and Mental Health Boards
Ombudsman for Corrections
Ombudsman for Mental Health and Mental Retardation
Podiatry Board
Pollution Control Agency
Public Defense Board
Public Service
Public Utilities Commission
Public Employment Relations Board
Public Defender

## NATIONAL BENEFITS UNITS

State Departments

Regional Transit Board
Revisor of Statutes
Secretary of State
Sentencing Guidelines Commission
Southwest State University
State Court Administrators (By County Allocation)
State Auditor
State Arts Board
State Judges (By County Allocation)
Supreme Court
Tax Court
Telecom Access Committee
Transportation Regulation Board
Transportation Study Board - Legislative Commission
Treasurer's Office
World Trade Center Board

## NATIONAL BENEFITS UNITS

<u>School Districts</u>

National Benefits is the Marketing Representative for the Minnesota School Districts that are not listed as Ochs Units.

## NATIONAL BENEFITS UNITS

Miscellaneous Departments

Metropolitan Transit Commission
Metropolitan Airport Commission
Willmar, City of
Willmar Public Utilities

## NATIONAL BENEFITS COUNTIES

Anoka
Benton
Blue Earth
Brown
Carlton
Carver
Clay
Clearwater
Cottonwood
Crow Wing
Dodge
Douglas
Fillmore
Freeborn
Grant
Hennepin
Houston
Jackson
Kanabec
Koochiching
Lincoln
Lyon
McLeod
Martin
Mille Lacs
Mower
Murray
Nobles
Olmsted
Pennington
Pipestone
Polk
Red Wood
Renville
Rice
Rock
St. Louis
Scott
Sibley
Steele

## NATIONAL BENEFITS COUNTIES

Todd
Wabasha
Waseca
Watonwan
Winona
Yellow Medicine

Any assigned client service unit encroachment after September 1, 1993, will result in a penalty to the service organization committing the infraction. After the encroachment is verified, a governmental subdivision, somewhat equal in the number of participants to the one being encroached upon, will be transferred from the firm which committed the infraction. Obviously, the encroached assigned service unit will remain with the assigned client service organization.

Exhibit B

# MINNESOTA STATE DEFERRED COMPENSATION PLAN SERVICES

It is the goal of the State of Minnesota Deferred Compensation Plan (DCP) to provide all public employees access to the plan. The materials and presentations should provide each eligible employee with an understanding of the advantages and disadvantages of deferring compensation, along with basic investment knowledge. All investment options will be presented in an understandable manner without bias.

The following services will be provided for the insurance companies and the State Supplemental Plan. Reasonable attempts should be made to provide these services, but circumstances may make it impossible to comply in every situation.

## 1. INITIAL ENROLLMENT

TASKS

A. Mail plan information and enrollment forms to new employees when requested by a new employee or by an employer.

B. Conduct group meetings at work site to explain plan when employer allows for on-site group presentations.

C. Meet with individuals at work site or office to discuss DCP and investment options; assist in completing necessary forms.

D. Publicize upcoming DCP meetings through letter, flyer, paycheck insert, or employer newsletter if approved by employer.

E. Verify deferrals meet all IRS and plan regulations. Contact participants to clarify questions on application before processing application.

F. Provide employers with enrollment forms for the Plan.

G. Provide information on basic investment strategies so participants can choose the investments that they feel are best suited for them. General investment information will be prepared by MSRS with input from service organizations.

H. Process all deferral requests and investment option forms to payroll centers and investment providers. If possible, payroll deduction information should be provided on diskette. Maintain records necessary to verify participant requests.

I. Provide phone and FAX access during normal working hours. Provide answering machine or answering service during non-working hours.

J. Present all investment options without bias.

K. Maintain and disseminate performance history and investment philosophy of all options as developed by MSRS.

L. Inform participants of all administrative costs for the different investment options based on information compiled by MSRS.

M. Inform participants of rules for transferring funds from one investment vehicle to another.

N. Verify that enrollment form is initialed, signed, and complies with all plan regulations.

O. Send welcome letter to all new enrollees with copy of application to verify information.

P. Explain acceptable reasons for hardship withdrawal to participants. Participants should be knowledgeable of hardship restrictions at the time of enrollment.

<u>INDICATORS</u>

1. Each new employee will receive an enrollment package within one week of the request. By request and cooperation of an employer, an enrollment package will be mailed to each new employee within two weeks of receiving a new employee list

2. Field representatives will conduct group and individual meetings once or twice each calendar year in each governmental subdivision or at the various locations for larger units, unless otherwise requested by employer.

3. Applications will be monitored, if possible, to make sure maximum contributions are not exceeded. Excess contributions will be returned under plan guidelines. When questions on application become evident, marketer should contact participant within two days to clear up the questions.

4. Toll free number and fax number will be included on all information provided to employees and employers. Adequate number of phone lines will be maintained.

5. Written materials and verbal presentations will explain all investment options, and include standardized rate of return comparison.

6. Initial deferrals and investment selections will be made during the next appropriate payroll cycle. Transfer of payroll deduction information by diskette should continue where it is now in use, and should be offered to employers to facilitate payroll deductions.

7. Errors in processing initial enrollment forms should be less than two percent. Errors should be corrected as soon as possible, and when appropriate, corrective measures should be explained to the participant in writing.

8. Upon initial enrollment, each participant will be given a copy of a brochure describing general investment strategies.

9. Every effort will be made to make sure that participants will understand the hardship withdrawal requirements as construed by MSRS.

## 2. ONGOING SERVICE TO PLAN PARTICIPANTS

<u>TASKS</u>

A. Assist with changes in amounts, investment allocations, and transfers. Answer questions regarding account balances and investment allocations.

B. Update participants on the performance history and investment philosophy of all investment options.

C. Continue to monitor that IRS and plan guidelines are followed by each participant.

D. When appropriate, inform participants of catch-up provisions and calculate the maximum amount eligible for catch-up provision.

E. Send letter, application, business reply return envelope, and other pertinent information to participants to facilitate deferral changes and investment option changes.

F. Maintain current data base information on each participant. The data base information should include: name, social security number, date of birth, address, employer, payroll cycle, current investment allocation, current contribution amount, current salary, identification of participants using catch-up provision, date of most recent application and effective pay date of most recent application. And, with the cooperation of investment providers, beneficiary designation(s).

G. Conduct group and individual meetings to continue education of deferred compensation participants.

H. Respond to written and phone requests to answer questions.

I. Process investment and deferral changes. Interact with payroll departments and investment providers to ensure accurate placement and amounts of deferrals.

J. Projections of future accumulations will be provided if requested.

INDICATORS

1. Field representatives will conduct group and individual meetings once or twice each calendar year in each governmental subdivision or at various locations for larger governmental units, unless otherwise requested by employer. Presentation level will be geared to knowledge of participants.

2. A toll free phone number will be maintained and almost all calls will be returned the same business day. Calls not returned the same day, must be returned the next working day.

3. Requests for brochures or other information will be mailed no later than three working days of the initial request. Account balances, investment allocations, and other questions that could be answered by phone will be completed the same working day if possible, but no later than the next working day.

4. Exceeding maximum 457 limits is not permissible. Excess contributions should be minimized and returned under plan guidelines.

5. Participants should be informed of catch-up provision prior to reaching age 50. Individuals utilizing the catch-up provision will be monitored to make sure catch-up does not extend beyond three-year period.

6. Each individual will be sent a letter each year with a form and business reply envelope to allow for a change in deferral and investment options. This can be incorporated with mailing of statements if possible.

7. Age-specific investment strategies will be developed by MSRS and sent to participants at least once every two years. All participants will receive standardized rate of return newsletter.

8. Projections of future accumulations will be mailed promptly, but no later than one week after requested. Projections should be based on a reasonable rate of return and should be slightly conservative. Disclaimers are required on all estimates.

9. All financial planning and investment information must be approved by MSRS and will contain disclaimers. Material must include disclaimers clarifying that service representatives are not certified financial planners.

10. Deferral or investment changes will be made during the next appropriate payroll cycle. Transfers from one investment product to another will be made no later than the next working day or next available investment cycle.

## 3. PRE-RETIREMENT TERMINATION

<u>TASKS</u>

A. Provide and assist with forms for withdrawal of funds.

B. Explain general tax implications of lump-sum withdrawal.

C. When applicable, assist with designation of payout date.

D. Forward payout election forms to appropriate investment provider and keep records necessary to verify payment.

E. Assist in processing emergency withdrawal requests.

   a. Explain acceptable reasons for hardship withdrawals and restrictions of future deferrals.

b. Assist in completion of forms and submit to MSRS for approval.

c. Send approval letter to appropriate investment provider.

d. Follow-up to make sure check is processed in a timely manner.

F. Assist in processing death claims. Send letter to beneficiary, meet with beneficiary if appropriate, and assist in establishing payout. Notify investment providers of payout selection.

<u>INDICATORS</u>

1. Participants will be mailed withdrawal forms within two working days of request.

2. All brochures explaining withdrawal and payout options will include general tax implication information. Withholding forms will be provided.

3. Employees not withdrawing funds at termination will designate a payout date in compliance with IRS regulations if notified of termination date.

4. Hardship withdrawal forms will be mailed no later than the next working day after requested.

5. Investment providers will be notified of hardship approval within one working day of receipt of MSRS approval documentation.

6. Participant deductions will be stopped for a one-year period for approved emergency withdrawals. Exception for minimum contribution required to achieve employer matching contributions.

7. Mail letter and information to beneficiary within one week of being notified of participant's death.

## 4. RETIREMENT

<u>TASKS</u>

A. Send letter to those who are nearing retirement, or have separated from service, regarding payout information and IRS regulations on designating a payout date.

B. Explain catch-up provision to eligible participants

C. Explain various payout options and provide estimates of the various fund alternatives.

D. Conduct group pre-retirement seminars as requested by employers and have field representative available for individual counseling.

E. Continue to provide age-specific, general investment strategies as developed by MSRS.

F. Notify payroll department to stop participant's deductions.

G. Assist in completion of proper payout forms and forward to appropriate investment provider. Maintain adequate records to verify payout information.

H. Respond to questions regarding on-going payments.

I. Explain tax withholding options on the various payout options.

J. Assist in completion of direct deposit forms.

K. Maintain record of selected future payout dates, and notify participants when approaching the designated date.

INDICATORS

1. Requests for payout information will be responded to within one week. Payout options from all providers will be explained.

2. Catch-up provision will be monitored to make sure maximums are not exceeded.

3. A letter explaining IRS distribution rules, payout options, and offering to calculate estimated payout options will be mailed to participants at age 55 and at least every other year thereafter.

4. Payout election forms will be sent to each participant at least two months prior to retirement or payout date - sooner if requested by participant.

5. All participants will be contacted one month prior to declared payout date if application is not submitted. If after one follow-up letter to the participant, the application is not received, the service organization will send a registered letter to the last known address of the participant explaining IRS distribution rules and requirements.

6. Phone and written requests from participants on payout status will be responded to within one working day.

7. Participants nearing retirement will be given an opportunity to meet with a field representative to discuss payout information at least once a year.

## 5. SERVICES PROVIDED TO EMPLOYERS

<u>TASKS</u>

A. Provide an updated employer handbook explaining the administrative requirements of the plan.

B. Respond to questions regarding reporting requirements, IRS rules, etc.

C. Prepare participation reports if requested by the employer

D. Assist payroll department to complete special one-time contributions or handle unusual circumstances.

E. Provide updated brochures and forms to employers.

F. Provide employers with total Plan assets as required by auditors if available.

G. Answer general tax reporting questions.

<u>INDICATORS</u>

1. Employer reporting handbook will be updated annually.

2. Each payroll/personnel director will be contacted yearly to ask for any questions or concerns and to determine if additional forms or meetings are needed.

3. Employer requested reports will be completed at a mutually agreeable deadline.

4. One-time deductions will be processed for the pay date specified on the application.

5. Written and phone requests will be responded to within two working days.

6. Payroll errors will be corrected by the next appropriate payroll cycle.

7. Asset information required by the auditor will be provided in a timely manner to facilitate completion of the audit report.

## 6. ADDITIONAL SERVICES

TASKS

A. Develop and design new plan forms to improve existing forms or to incorporate changes.

B. Provide business reply envelope for all forms that should or can be returned.

C. Process one-time contributions as allowed by employment contract or plan regulations.

D. Provide information to employers regarding matching employer contributions. Be available as resource to assist employer in publicizing matching program. The following services should be provided after implementation of the employer matching contribution:

   a. Send letter to all eligible employees if requested by employer.

   b. Conduct group and individual presentations as requested by the employer.

   c. Maintain statistical information to measure the success of matching program.

   d. Assist employer in writing articles in publications announcing the matching program.

E. Assist in correcting errors made by MSRS, marketers, investment providers, or payroll clerks.

F. Suggest changes to improve the Plan. The proposed changes could include, but should not be limited to, administrative, products, materials, and Plan rules.

G. Help determine the impact of new state and federal laws that may affect the plan.

H. Prepare reports as requested by MSRS.

INDICATORS

1. Forms will be reviewed at least annually to make sure forms are current. All forms must be approved by MSRS.

2. One-time contributions must be processed during the next available payroll cycle.

3. Group and individual meetings will be conducted when initiating an employer matching program.

4. Attempts to correct errors will be started within one working day of identifying the error.

5. Recommendations for changes or not making changes regarding item "F" above will be submitted each January. Requests for input on any proposed federal and state law changes will be submitted in writing within two working days after being advised of proposed federal and state law changes unless otherwise agreed upon by the Executive Director.

6. Reports requested by MSRS will be submitted within a mutually agreeable time frame.

**STAFF TRAINING AND EDUCATION**

Continued training and education is important to make sure each representative is familiar with all aspects of the Minnesota State Deferred Compensation Plan. Training should, at a minimum, include 15 hours of approved continuing education each year. Annual or semi-annual meetings should be conducted with all representatives to keep abreast of Plan rules and current trends.

All agents should have the following licenses:

Life/Accident Health Insurance
Series 63, Blue Sky Laws
Series 6

Agents shall be licensed to sell all insurance products if current arrangement is modified to equally market all products.

The marketing organization should maintain membership in the National Association of Government Deferred Compensation Administrators.

# Service Agreement with Ochs Services Agency

**MARKETING AND SERVICE AGREEMENT**
**Minnesota State Deferred Compensation Plan**

This Marketing and Service Agreement ("Agreement") is entered into by and between the State of Minnesota ("State"), acting through the Minnesota State Retirement System Board ("Board") on behalf of the Minnesota State Deferred Compensation Plan ("Plan"), and Ochs Services, a Minnesota corporation, a deferred compensation plan service organization.

**WHEREAS**, the State has established an eligible Deferred Compensation Plan pursuant to Section 457 of the Internal Revenue Code and Minn. Stat. § 352.96 for the benefit of its employees and employees of the political subdivisions of the State; and

**WHEREAS**, the Executive Director of the Minnesota State Retirement System with the advice and consent of the Board of Directors must administer the Plan; and

**WHEREAS**, the Board desires assistance in enrollment, marketing, and service functions to operate the plan in accordance with the requirements of the Minnesota Statutes and Internal Revenue Code; and

**WHEREAS**, Ochs Services represents itself to be experienced and qualified and capable of providing the necessary marketing and service functions for the operation of the Plan and has provided such functions for the Board in the past; and

**WHEREAS**, the Board desires to continue Ochs Services as a marketing and service organization for the Plan and Ochs Services desires to provide such services according to the terms of this Agreement;

**NOW, THEREFORE**, the parties to this Agreement agree as follows:

**ARTICLE 1**

**1. DEFINITIONS**

In this Agreement, the following terms shall be defined as set out in this Article.

1.1 **"Employer"** shall mean:

1) the State, or

2) a political subdivision of the State, or an agency or instrumentality of the State or its political subdivisions.

1.2 **"Employee"** shall mean an employee eligible for participation in the plan under § 352.96.

1.3 **"Plan"** shall mean the State of Minnesota Deferred Compensation Plan created under Minn. Stat. § 352.96.

1.4 **"Assigned Client Service Units"** shall mean the governmental units for which Ochs Services agrees to perform marketing and other required services under this contract designated for Ochs Services in the attached Exhibit A, the terms of which are incorporated herein. Any changes in assigned client service units shall only be made upon mutual agreement by the participating service organizations and the Executive Director. Upon termination of this agreement, Exhibit A is null and void.

1.5 **"Eligible Employees"** shall mean the employees in the assigned client service units assigned by the Executive Director of the Minnesota State Retirement System.

1.6 **"Board"** shall mean the Board of Directors of the Minnesota State Retirement System.

1.7 **"Executive Director"** shall mean the Executive Director of the Minnesota State Retirement System.

1.8 **"Required Services"** shall mean the detailed listing of required services in the document entitled "Required Services" attached to this Agreement as Exhibit B.

1.9 **"Investment Product"** shall mean an investment option approved by the State Board of Investment for offering to Plan participants and provided by product provider.

1.10 **"Product Provider"** shall mean any company that has a contract with the State Board of Investment to offer an investment product under the Plan or the State of Minnesota Supplemental Fund.

1.11 **"Non-annuitized Assets"** shall mean accumulation values less amounts which have been applied to purchase any annuity option. Amounts held for systematic withdrawal will be included as non-annuitized assets.

## ARTICLE 2

## 2. GENERAL TERMS AND PROVISIONS

2.1 **Appointment.** The Board authorizes and appoints Ochs Services to service and market the Plan for the term of this Agreement.

2.2 **Effective Date and Term of the Agreement.** Ochs Services shall service and market the Plan commencing on September 1, 1994 and ending on June 30, 1999, unless this Agreement is terminated earlier in accordance with Article 8 of the Agreement.

2.3 **Execution of the Agreement.** This Agreement becomes binding upon the Board and Ochs Services when it is reviewed and approved by the Board or its representative and the State Board of Investment pursuant to Minn. Stat. § 352.96 and signed by authorized representatives for each party. By their signatures, the parties' representatives represent that they have legal authority to sign and bind their principals and that each party has all required legal right and power to perform all acts called for by this Agreement in the State of Minnesota and elsewhere.

2.4 **Governing Law and Forum Selection.** This Agreement is entered into in the State of Minnesota and shall be construed and interpreted in accordance with its laws. In the event any dispute arises under this Agreement which the parties cannot resolve by mutual consent, such dispute, including responsibility for the cost of resolving the dispute, shall be resolved and determined through mediation or binding arbitration under the rules of the American Arbitration Association.

## ARTICLE 3

## 3. OCHS SERVICES' MARKETING AND SERVICE RESPONSIBILITIES

3.1 **Administrative Duties and Services.** Ochs Services is responsible for educating eligible employees regarding all aspects of the Plan and the effect of their participation in the Plan. The information which Ochs Services presents to eligible employees shall be factual and clearly presented and shall fully disclose all costs, rates of return, transfer rights, and plan features, both positive and negative, so as to enable all eligible employees to determine whether they wish to participate in the Plan and the extent of any participation. Ochs Services' marketing and service duties shall include, but are not limited to the list of required services attached as Exhibit B. Additional duties may be assigned and current duties altered upon request by the Executive Director, based upon reasonable change in needs and circumstances, provided these do not result in substantial changes in cost to Ochs Services.

3.2 **Only Approved Investment Products and Exclusive Marketing Agreement.** Ochs Services shall not solicit business from any eligible employee for any other Section 457 Deferred Compensation Plan in Minnesota. Further, Ochs Services shall abide by the same rules that each employer has established regarding the contacting of employees for any other type of business or services, including, but not limited to, marketing tax sheltered annuities under Section 403B. If Ochs Services is making a presentation or conducting a meeting as a representative of the Plan, only general information about any other type of business or service agreement can be discussed. Specific products offered through any other type of business or service agreement cannot be discussed while serving as a representative of the Plan without prior written approval from the employer

3.3 **Representatives and Licensing.** Ochs Services will employ an adequate number of marketing and service representatives to provide the required services to all eligible employees regarding all aspects of the Plan, and shall maintain adequate continuing service to all eligible employees.

Ochs Services is responsible for obtaining and maintaining all licensing required by any local, state, or federal agencies and any product providers for all Ochs Services employees engaged in marketing or servicing employees in the Plan. Any employee of Ochs Services who does not have all necessary licensure shall not be permitted to solicit any employee for enrollment in the Plan. Ochs Services shall also obtain and maintain all required local, state, and federal licenses, permits, and franchises necessary to carry out its responsibilities under this Agreement. Ochs Services agrees that its directors, officers, agents, and employees shall not receive or handle any funds deferred by participants under the Plan except as provided in this Agreement. Ochs Services further agrees to report the names and license numbers of its representatives to the Executive Director and that none of its representatives will be permitted to market and service the Plan unless the representatives' names and license numbers have been submitted in writing to the Executive Director.

If, at any time, the Board believes that an Ochs Services representative is not satisfactorily complying with the provisions of this Agreement as to the marketing and servicing of the Plan Participants, it shall notify Ochs Services in writing of the reason for this dissatisfaction. If, after 30 days following the Board's written notice, the Board believes that the situation has not been corrected to its satisfaction, Ochs Services shall agree to withdraw its representative from the Plan. The Board also has the right to require immediate withdrawal if the Board determines that a representative is involved in misrepresentation of investment products or rules or other fraudulent or criminal activity. Prior to requiring withdrawal of a representative, the Board shall provide the representative and Ochs Services with reasonable notice of its proposed action and an opportunity to be heard before the Board.

3.4 **Representative Compensation.** Ochs Services shall not compensate its representatives in any manner that would promote participant investment in a particular investment product.

Ochs Services shall represent and market all investment products offered under the Plan in an equal and unbiased manner and shall provide the Board with the compensation plan or formula used to pay its representatives and staff.

3.5 **Marketing Materials and Forms.** Prior to distribution or presentation to eligible employees and employers, Ochs Services will prepare and submit to the Executive Director for approval drafts of all literature, forms, newsletters, video presentations, and scripts or outlines of oral presentations regarding the Plan to be provided to employees and payroll personnel. The data contained in all such marketing literature and other written visual aids prepared by Ochs Services for use with the Plan shall at all times be the property of the State, and Ochs Services shall not obtain or reserve any proprietary or literary rights with respect to any such data. Upon request of the Board, Ochs Services shall execute any assignments or releases necessary to convey any proprietary rights it may have to the State. Only material and forms approved by the Executive Director may be made available to eligible employees and employers.

Ochs Services shall not represent itself to eligible employees as qualified financial planners and shall provide only general financial advice which has been approved by the Executive Director.

The product providers shall be responsible for the costs associated with the printing of a reasonable number of the materials as listed in the Deferred Compensation Plan business agreement. All other printing costs and mailing costs shall be the responsibility of Ochs Services. The product providers shall be responsible for all expenses associated with the connection of Ochs Services' data transmissions and product providers computers.

3.6 **Employee Meetings.** Ochs Services agrees to conduct employee meetings, with the permission of the employer, during work hours at employee work stations. No such contacts are to be made by any representative of Ochs Services unless they are scheduled in advance and the employer has made arrangements for the representative to meet with eligible employees. No contacts are to be made at an employee's residence unless requested by the employee. A representative may not suggest a meeting at an employee's residence.

Ochs Services agrees to provide prior notice to the Executive Director of any group presentations and group meetings. Requests for follow-up meetings must be approved by the employer.

3.7 **Reports to the Executive Director.** Ochs Services shall furnish to the Executive Director each month a report describing the level of enrollment and participation in the Plan as requested by the Executive Director. The monthly report shall also list by employer the date of any employee group meetings.

Ochs Services also agrees to provide the Executive Director with information and reports as may be reasonably required by the Board or the Executive Director to enable them to carry out their responsibilities.

3.8 **Employee Complaint Procedure.** Ochs Services will respond to all participant complaints within five work days and, whenever reasonably possible, resolve complaints relating to their responsibility within five additional work days. Ochs Services will submit monthly reports to the Executive Director listing the written complaints received along with the status, and any resolutions, of the complaints All written complaints and written responses will be submitted along with the monthly report. Any complaints not resolved between the complainant and Ochs Services may be submitted to the Executive Director who shall resolve the dispute through the issuance of a written decision. Either party may request Board review of the Executive Director's determination, and the Board's decision shall be final.

## ARTICLE 4

## 4. RESPONSIBILITIES OF THE BOARD AND EXECUTIVE DIRECTOR

4.1 **Maintenance of Eligible Plan.** The Board shall maintain the Plan as an "eligible deferred compensation plan" within the meaning of Section 457 of the Internal Revenue Code.

4.2 **Approval of Investment Contractors.** The State Board of Investment shall designate those investment contracts that are approved for use in the Plan.

4.3 **Necessary Approvals.** The Board or its Executive Director shall provide timely information and approvals as are reasonably required by Ochs Services for the maintenance, operation, and communication of the Plan.

4.4 **Operating Decisions.** The Board or its Executive Director shall be responsible for making, to the extent not otherwise delegated, all decisions necessary for the operation of the Plan, including, without limitation, decisions authorizing or denying early withdrawals in the event of an unforeseeable financial emergency in accordance with the Plan.

4.5 **Review.** The Executive Director will conduct at least semi-annual reviews with Ochs Services to insure compliance with the terms of this Agreement. The product providers will be invited to attend the reviews or submit any comments in writing to be included as part of the reviews. The Executive Director will summarize the reviews in writing. Ochs Services can provide written comments within one week after the review to be attached to the written reviews.

## ARTICLE 5

## 5. COMPENSATION TO OCHS SERVICES

5.1 **Compensation.** Ochs Services shall receive compensation for performing its required services based on the following formula:

| Period | Annual Basis Points (paid on total non-annuitized assets for eligible employees in assigned client service units) |
|---|---|
| September 1, 1994 to June 30, 1995 | 33 |
| July 1, 1995 to June 30, 1996 | 31 |
| July 1, 1996 to June 30, 1997 | 30 |
| July 1, 1997 to June 30, 1998 | 29 |
| July 1, 1998 to June 30, 1999 | 28 |

Ochs Services will receive 1/12th of the annual basis point amount each month based on the non-annuitized assets in their assigned client service unit at the end of each month.

In addition, a one-time 1 1/2% commission shall be paid to Ochs Services the month following commencement of annuitization occurring during the term of this Agreement for eligible employees in Ochs Services' assigned client service unit. Ochs Services shall also receive the commission for annuity applications received prior to termination of this agreement provided annuity payments commence within 60 days of termination of this agreement. Payment will be paid the month following commencement of the annuity.

The product providers shall provide Ochs Services and the Executive Director the data and documentation necessary to confirm that Ochs Services is being properly compensated.

Ochs Services shall not be eligible for any further compensation following the termination of this Agreement and Ochs Services waives all rights to future compensation from any product providers based upon services provided under this Agreement or any prior agreement.

5.2 **No Additional Compensation.** Ochs Services shall not accept any additional compensation or emoluments other than the amounts described in Article 5.1 for services provided under this agreement. The acceptance of any additional compensation or emoluments by Ochs Services from product providers shall be just cause for the termination of this Agreement.

Services rendered prior to the effective date of this contract by Ochs Services under contract with a product provider are subject to the compensation terms of the previous contract. All compensation paid under a previous contract must be completed within six months of the effective date of this agreement and the amounts must be reported to the Executive Director.

5.3 **Method of Payment.** Ochs Services shall be compensated under the terms of Article 5.1 on a monthly basis. Each product provider will pay the required basis points directly to the Ochs Services within 20 days of month end. An estimated payment can be made to expedite payment to Ochs Services as long as the exact amount due is balanced on at least a quarterly basis.

The product providers shall pay interest as specified in Minnesota Statutes § 334.01, subdivision 1 on the date of this agreement if payment is 30 or more days past due.

5.4 Ochs Services shall sign any necessary agreements with the appropriate product provider to sell all approved investment products.

## 6. RECORDS

6.1 **Books and Records are Property of the Board.** Ochs Services shall maintain adequate records relating to participants, including but not limited to, participant correspondence, written notes of complaints registered by phone, beneficiary designations, tax withholding forms, and any forms relating to investment allocation and transfers, or withdrawal decisions for the duration of this Agreement. Ochs Services may utilize microfilm or other similar medium approved by the Executive Director for this purpose.

All data contained in books, records, documents, and other information relating to the Plan maintained by Ochs Services shall at all times remain the property of the Board. Upon termination of this Agreement for any reason, Ochs Services shall provide copies of all data and documents identified in the first paragraph of this article to the Executive Director within one month.

The parties recognize and agree that all books, records, documents and accounting procedures and practices of Ochs Services relevant to the transactions and services provided under this agreement are subject to examination and audit pursuant to the provisions of Minn. Stat. § 16B.06, subd. 4.

6.2 **Confidentiality of Information.** Each party acknowledges that it may have access to information of a confidential nature, which information is the exclusive property of the other party.

Neither party will, without express written authorization from the other party, disclose any confidential information relating to the other party or relating to any of its controlled or affiliated corporations or organizations, or other related entities.

All records of the Plan shall be used only for the purposes of the Plan and shall be held confidential by Ochs Services. This obligation shall continue upon expiration or termination of this Agreement. However, any records, reports, or other information relating to the Plan may be made available upon instructions by the Board, to any State authority or to any other person or entity.

## ARTICLE 7

## 7. INDEMNIFICATION AND INSURANCE

7.1 **Liability.** Ochs Services agrees to indemnify and save and hold the State, its agents and employees harmless from any and all claims or causes of action arising from the performance of this contract by Ochs Services or Ochs Services' agents or employees This clause shall not be construed to bar any legal remedies contractor may have for the state's failure to fulfill its obligations pursuant to this contract. Product providers or other marketing organizations shall not be contstrued as agents or employees of Ochs Services.

7.2 **Insurance.** Ochs Services shall maintain errors and omissions insurance covering its representatives in the amount of at least $100,000 per occurrence, relating to the services provided by Ochs Services under this Agreement. Ochs Services agrees to provide the Board with appropriate evidence of such insurance and promptly notify the Board of any lapse, cancellation, or expiration of any such insurance

## ARTICLE 8

## 8. TERMINATION

8.1 **Termination for Cause.** Neither party shall terminate this Agreement prior to its expiration date except for just cause. If either party elects to terminate the Agreement for just cause, thirty days written notice must be provided.

Reasons for termination for just cause include, but are not limited to.

1) Failure to comply with the obligations, requirements, or duties of this Agreement.

2) Misrepresentation of product, state law, federal law, or plan rules.

3) Providing financial or investment advice that is not approved by the Board or Executive Director.

4) Unequal representation of products.

5) Ochs Services' acceptance of compensation or emoluments not provided for in Article 5.1.

6) Falsifying records.

7) If the intended purposes of this agreement are substantially altered or frustrated.

8.2 **Termination of Obligations.** Following the expiration or termination (as provided above) of this Agreement, Ochs Services shall have no continuing obligation (except as otherwise expressly provided by this Agreement) with respect to any undertaking made in this Agreement.

8.3 **Return of Records.** At the expiration or termination of the Agreement, Ochs Services will turn over all physical files and all required data pertaining to the plan in a reasonable format acceptable to the Board. Ochs Services will return all files and data to the Board in a mutually agreeable time frame but in no case later than thirty days after the termination or expiration of the Agreement.

8.4 **Transfer of Ownership of Ochs Services.** Ochs Services shall not sell or transfer its business assets or the majority of its stock without the consent of the Board which consent shall not be unreasonably withheld. This provision shall not apply to transfers of Ochs Services between or among family members of the existing owners, for which no consent is required.

## ARTICLE 9

## 9. MISCELLANEOUS

9.1 **Entire Agreement.** The parties agree that this Agreement contains the entire agreement between the parties with respect to the matters set forth and supersedes any prior agreements and negotiations between the parties. The parties further agree that any written contracts with product providers pertaining to the Minnesota State Deferred Compensation 457 Plan other than specified in Article 5.4 must be terminated by September 1, 1994. Proof of contract termination must be submitted to the Executive Director.

9.2 **Amendment.** The parties agree that any modifications to this Agreement must be in writing. Any changes in compensation as outlined in Article 5 must be signed by all other service organizations participating under the Plan and the Executive Director with Board approval.

9.3 **Headings.** The headings and numbering of parts of this Agreement are included solely for convenience of reference and shall not control or affect the meaning or interpretation of this Agreement.

9.4 **Execution by Counterparts.** Execution of separate copies of this Agreement by each of the parties shall have the same force and effect as though both parties had executed the original of this Agreement.

9.5 **Compliance with Applicable Laws.** Ochs Services shall comply with all applicable federal, state and local laws in performing the services required under this Agreement, including but not limited to, applicable affirmative action requirements under state law, workers' compensation obligations under state law, and agrees that its books and records relating to its services hereunder are subject to examination by the Board and the legislative auditor.

9.6 **Subcontracts.** Ochs Services shall not subcontract any of its responsibilities under this Agreement without the prior written approval of the Board except for nonadministrative duties other than record keeping.

9.7 **Affirmative Action.** If Ochs Services employs more than twenty people, they will certify that they have received a certificate of compliance from the Commissioner of Human Rights pursuant to Minnesota Statutes § 363.073.

9.8 **Workers' Compensation.** In accordance with the provisions of Minnesota Statutes §176.182, the State affirms that Ochs Services has provided acceptable evidence of compliance with the workers' compensation insurance coverage requirement of Minnesota Statutes § 176.181, subdivision 2.

MINNESOTA STATE
RETIREMENT SYSTEM

By:__________________________
DAVID BERGSTROM
Executive Director

Dated:________________________

OCHS SERVICES

By:__________________________
President

Dated:________________________

**APPROVED:**

MINNESOTA STATE BOARD OF
INVESTMENT

By:__________________________
Howard Bicker
Executive Director

Dated:________________________

Approved as to form and execution:

ATTORNEY GENERAL

By:__________________________
JON K. MURPHY
Assistant Attorney General

Dated:________________________

COMMISSIONER OF ADMINISTRATION

By:__________________________

Dated:________________________

COMMISSIONER OF FINANCE

By:__________________________

Dated:________________________

Exhibit A

**MINNESOTA DEFERRED COMPENSATION CLIENT SERVICE UNITS
ASSIGNED TO THE MARKETING REPRESENTATIVES
OCHS SERVICES AND NATIONAL BENEFITS
BY THE MINNESOTA STATE RETIREMENT SYSTEM**

The units are split into one of the four following headings:

**State Department**

State employees

**Minnesota Counties**

Includes employees of the 87 Minnesota counties, also includes all employees of cities and other political subdivisions within each county.

Exception

Employees *not* included under the County heading are:

State employees
School District employees
Other miscellaneous employees

**School District**

Includes all School Districts within the State of Minnesota

*Does not* include State Universities, Community Colleges or State Schools.

**Miscellaneous Units**

Units that are exceptions to the three headings above.

# Minnesota Deferred Compensation

# Client Service Units

# Assigned to

# Ochs Services

# by

# The Minnesota State Retirement System

## OCHS SERVICES UNITS

State Departments

Administration
Administration and Finance - Zoological Garden
Agriculture
Ah-Gwah-Ching
American Legion
Animal Health
Anoka Regional Treatment Center
Arrowhead Community College
Arts School (Minnesota Center for Arts Education)
Assessors, Board of
Austin Community College
Bemidji State University
Board of Boxing
Board of Barber Examiners
Board of Electricity
Board of Arch., Engineering
Board of Accountancy
Brainerd Community College
Brainerd Regional Treatment Center
Cambridge Regional Treatment Center
Cambridge Center
Capitol Child Care Center
Clearwater Community College
Client Security Board
Commerce
Community College Board Office
Corrections
Council of Economic Status of Women
Council for Handicapped
Council on Vo Tech Education
Court of Appeals
Court Administrators (By County Allocation)
Dept. of Human Services - Central office
Disability Council
District Court Judges (By County Allocation)
Employee Relations

## OCHS SERVICES UNITS

State Departments

Faribault Regional Treatment Center
Fergus Falls Regional Treatment Center
Fergus Falls Community College
Gambling Control Board (including MN State Lottery)
Gillette Hospital
Governor's Manpower Office
Governor's Office
Governor's Appointments Committee
Governor's Residence Council
Hazardous Sub. Compensation Board
Hibbing Community College
Higher Education Facilities Authority
Horticultural Society
House of Representatives Staff
Inver Hills Community College
Iron Range Resources and Rehabilitation
Itasca Community College
Job Skills Board
Labor & Industry
Lakewood Community College
Law Enforcement Training Center
Lawyers Professional Responsibility Board
Legislative Reference
Legislative Commission on Employee Relations
Legislative Retirement Study Commission
Legislative Coordinating Commission
Legislative Audit Commission
Legislative Commission on Planning and Fiscal Policy
Legislative Commission to Review Administration
Legislature
Lieutenant Governor
Lino Lake Corrections
Mediation Services
Mesabi Community College
Minneapolis Community College
Minnesota Housing Finance
Minnesota State Retirement System

## OCHS SERVICES UNITS

State Departments

Minnesota Resources Commission
Minnesota Humanity Commission
Minnesota Safety Council
Minnesota Municipal Board
Moorhead State University
Moose Lake Regional Treatment Center
North Hennepin Community College
Northland Community College
Oak Park Heights Corrections
Oak Terrace Nursing Home
Office of Waste Management
Office of Administrative Hearings
Public Safety - State Patrol
Public Employees Retirement Association
Public Safety - Capitol Security
Public Safety - Licensing
Public Safety - Liquor Control
Public Safety - Administration
Public Safety - Emergency Services
Public Safety - Criminal Apprehension
Public Safety - Fire Safety
Rainy River Community College
Red Wing Corrections
Representatives
Rochester Community College
Sauk Centre Corrections
Senate Staff
Senators
Shakopee Corrections
Spanish Speaking Affairs Council
St. Cloud Corrections
St. Peter Regional Treatment Center
St. Cloud State University
State Planning Agency (Minnesota Planning Office)
State University Board
State Judges (By County Allocation)
State Fair
Stillwater Corrections

## OCHS SERVICES UNITS

State Departments

Teachers Retirement Association
Thistledew Camp
Trade & Economic Development, Department of
Vermilion Community College
Veterans of Foreign Wars
Veterans Affairs
Veterans Home
Water Resources Board
Willow River Camp
Willmar Regional Treatment Center
Willmar Community College
Winona State University
Workers Compensation Court of Appeals
Worthington Community College

## OCHS SERVICES UNITS

School Districts

Ada
Aitkin
Annandale
Appleton
Argyle
Atwater
Audubon
Badger
Battle Lake
Beardsley
Becker
Bellingham
Benson
Big Lake
Blackduck
Blue Earth
Borup
Braham
Breckenridge
Browns Valley
Cambridge-Isanti
Campbell-Tintah
Cass Lake
Chisago Lakes
Chokio-Alberta
Cold Spring
Cook County
Cosmos
Cyrus
Dassel-Cokato
Delavan
Detroit Lakes
Eden Valley
Elmore
Fergus Falls
Finlayson
Forest Lake
Franconia

## OCHS SERVICES UNITS

School Districts

Frazee
Fridley
Greenbush
Grove City
Grygla
Halstad-Hendrum
Hancock
Henning
Hinckley
Howard Lake
Inver Heights
Karlstad-Strandquist
Kelliher
Kennedy
Kenyon
Kerkhoven-Murdock-Sunburg
Kimball
Kittson Central
Lac Qui Parle Valley
Lake of the Woods
Lake Park
Lancaster
Laporte
LeSueur-Henderson
Madison-Marietta-Nassau
Mahtomedi
Maynard
Middle River
Milan
Minnewaska
Montevideo
Monticello
Montogomery
Morris
Moundsview
Nevis
New London-Spicer
Newfolden

## OCHS SERVICES UNITS

School Districts

Norman County East
North St. Paul/Maplewood
North Branch
Oklee
Oslo
Parkers Prairie
Pelican Rapids
Perham
Pillager
Pine Point
Pine City
Pine River-Backus
Plummer
Prinsburg
Raymond
Red Wing
Red Lake
Remer
Roseau
Roseville
Rothsay
Rush City
Sebeka
South St. Paul
St. Paul
Stephen
Stillwater
Twin Valley
Underwood
United South Central
Wanamingo
Warren-Alvarado
Warroad
Waterville-Elysian-Morristown
Waubun
West St. Paul School
Wheaton
White Bear Lake

## OCHS SERVICES UNITS

Miscellaneous Departments

Cuyuna Range District Hospital (Crow Wing County)
Douglas County Hospital (Douglas County)
Granite Falls Municipal Hospital (Yellow Medicine County)
Greater Minnesota Corporation (Minnesota Technology Inc.)
Hutchinson Community Hospital (McLeod County)
Lakefield Municipal Hospital (Jackson County)
Metro Waste Control Commission
Metropolitan Council
Middle Management Association
Minnesota Association of Professional Employees
Northfield City Hospital (Rice County)
Worthington Regional Hospital (Nobles County)

If, at some time in the future, these units (any one or all) should again become eligible for the State Deferred Compensation Plan, they will revert back to their original assigned client service unit of Ochs Services. The units are:

Highway Credit Union
Minnesota Government Engineers Council
State Capitol Credit Union
State Employees Union

## OCHS SERVICES COUNTIES

Aitkin
Becker
Beltrami
Big Stone
Cass
Chippewa
Chisago
Cook
Dakota
Faribault
Goodhue
Hubbard
Isanti
Itasca
Kandiyohi
Kittson
Lac Qui Parle
Lake
Lake of the Woods
LeSueur
Mahnomen
Marshall
Meeker
Morrison
Nicollet
Norman
Ottertail
Pine
Pope
Ramsey
Red Lake
Roseau
Sherburne
Stearns
Stevens
Swift
Traverse
Wadena
Washington
Wilkin
Wright

**Minnesota Deferred Compensation**

**Client Service Units**

**Assigned to**

**National Benefits**

**by**

**The Minnesota State Retirement System**

## NATIONAL BENEFITS UNITS

State Departments

Amateur Sports Commission
Anoka-Ramsey Community College
Attorney General
Board of Psychology
Board of Optometry
Board of Nursing Home Administrators
Board of Veterinary Medicine
Board of Investment
Board of Social Work
Board of Marriage and Family Therapy
Board of Medical Examiners
Board of Unlicensed Mental Health Service
Board of Nursing
Board of Pharmacy
Board of Dentistry
Board of Chiropractors
Capitol Area Arch. and Planning Board
Continuing Legal Education Board
Department of Revenue
District Court Judges (By County Allocation)
DOT - Golden Valley
DOT - Rochester
DOT - Mankato
DOT - Willmar
DOT - Oakdale
DOT - Central Office
DOT - Duluth
DOT - Bemidji
DOT - Brainerd
DOT - Detroit Lakes
Economic Security
Education - Vo-Tech
Education
Education - Faribault
Education, State Board of
Employees Assistance Program
Ethical Practices Board
Finance

## NATIONAL BENEFITS UNITS

State Departments

Full Productivity and Opportunity Office
Gaming Department - Racing Division
Health
Health Care Access Commission
Health Facilities Complaints, Office of
Higher Education Coordinating Board
Historical Society
Human Rights
Indian Affairs
Judicial Standards
Law Examiners
Law Library
Legislative Commission on Waste Management
Legislative Commission on Long Term Health Care
Legislative Commission on Public Education
Mankato State University
Metropolitan State University
Military Affairs
Minnesota Racing Commission
Natural Resources - Region 6
Natural Resources - Central Office
Natural Resources - Region 1
Natural Resources - Region 2
Natural Resources - Region 3
Natural Resources - Region 4
Natural Resources - Region 5
Normandale Community College
Office of Social Work and Mental Health
Office of Social Work and Mental Health Boards
Ombudsman for Corrections
Ombudsman for Mental Health and Mental Retardation
Podiatry Board
Pollution Control Agency
Public Defense Board
Public Service
Public Utilities Commission
Public Employment Relations Board
Public Defender

## NATIONAL BENEFITS UNITS

State Departments

Regional Transit Board
Revisor of Statutes
Secretary of State
Sentencing Guidelines Commission
Southwest State University
State Court Administrators (By County Allocation)
State Auditor
State Arts Board
State Judges (By County Allocation)
Supreme Court
Tax Court
Telecom Access Committee
Transportation Regulation Board
Transportation Study Board - Legislative Commission
Treasurer's Office
World Trade Center Board

## NATIONAL BENEFITS UNITS

School Districts

National Benefits is the Marketing Representative for the Minnesota School Districts that are not listed as Ochs Units.

## NATIONAL BENEFITS UNITS

Miscellaneous Departments

Metropolitan Transit Commission
Metropolitan Airport Commission
Willmar, City of
Willmar Public Utilities

## NATIONAL BENEFITS COUNTIES

Anoka
Benton
Blue Earth
Brown
Carlton
Carver
Clay
Clearwater
Cottonwood
Crow Wing
Dodge
Douglas
Fillmore
Freeborn
Grant
Hennepin
Houston
Jackson
Kanabec
Koochiching
Lincoln
Lyon
McLeod
Martin
Mille Lacs
Mower
Murray
Nobles
Olmsted
Pennington
Pipestone
Polk
Red Wood
Renville
Rice
Rock
St. Louis
Scott
Sibley
Steele

## NATIONAL BENEFITS COUNTIES

Todd
Wabasha
Waseca
Watonwan
Winona
Yellow Medicine

Any assigned client service unit encroachment after September 1, 1993, will result in a penalty to the service organization committing the infraction. After the encroachment is verified, a governmental subdivision, somewhat equal in the number of participants to the one being encroached upon, will be transferred from the firm which committed the infraction. Obviously, the encroached assigned service unit will remain with the assigned client service organization.

Exhibit B

# MINNESOTA STATE DEFERRED COMPENSATION PLAN SERVICES

It is the goal of the State of Minnesota Deferred Compensation Plan (DCP) to provide all public employees access to the plan. The materials and presentations should provide each eligible employee with an understanding of the advantages and disadvantages of deferring compensation, along with basic investment knowledge. All investment options will be presented in an understandable manner without bias.

The following services will be provided for the insurance companies and the State Supplemental Plan. Reasonable attempts should be made to provide these services, but circumstances may make it impossible to comply in every situation.

## 1. INITIAL ENROLLMENT

TASKS

A. Mail plan information and enrollment forms to new employees when requested by a new employee or by an employer.

B. Conduct group meetings at work site to explain plan when employer allows for on-site group presentations.

C. Meet with individuals at work site or office to discuss DCP and investment options; assist in completing necessary forms.

D. Publicize upcoming DCP meetings through letter, flyer, paycheck insert, or employer newsletter if approved by employer.

E. Verify deferrals meet all IRS and plan regulations. Contact participants to clarify questions on application before processing application.

F. Provide employers with enrollment forms for the Plan.

G. Provide information on basic investment strategies so participants can choose the investments that they feel are best suited for them. General investment information will be prepared by MSRS with input from service organizations.

H. Process all deferral requests and investment option forms to payroll centers and investment providers. If possible, payroll deduction information should be provided on diskette. Maintain records necessary to verify participant requests.

I. Provide phone and FAX access during normal working hours. Provide answering machine or answering service during non-working hours.

J. Present all investment options without bias.

K. Maintain and disseminate performance history and investment philosophy of all options as developed by MSRS.

L. Inform participants of all administrative costs for the different investment options based on information compiled by MSRS

M. Inform participants of rules for transferring funds from one investment vehicle to another.

N. Verify that enrollment form is initialed, signed, and complies with all plan regulations.

O. Send welcome letter to all new enrollees with copy of application to verify information.

P. Explain acceptable reasons for hardship withdrawal to participants. Participants should be knowledgeable of hardship restrictions at the time of enrollment.

INDICATORS

1. Each new employee will receive an enrollment package within one week of the request. By request and cooperation of an employer, an enrollment package will be mailed to each new employee within two weeks of receiving a new employee list

2. Field representatives will conduct group and individual meetings once or twice each calendar year in each governmental subdivision or at the various locations for larger units, unless otherwise requested by employer.

3. Applications will be monitored, if possible, to make sure maximum contributions are not exceeded. Excess contributions will be returned under plan guidelines. When questions on application become evident, marketer should contact participant within two days to clear up the questions.

4. Toll free number and fax number will be included on all information provided to employees and employers. Adequate number of phone lines will be maintained.

5. Written materials and verbal presentations will explain all investment options, and include standardized rate of return comparison.

6. Initial deferrals and investment selections will be made during the next appropriate payroll cycle. Transfer of payroll deduction information by diskette should continue where it is now in use, and should be offered to employers to facilitate payroll deductions.

7. Errors in processing initial enrollment forms should be less than two percent. Errors should be corrected as soon as possible, and when appropriate, corrective measures should be explained to the participant in writing.

8. Upon initial enrollment, each participant will be given a copy of a brochure describing general investment strategies.

9. Every effort will be made to make sure that participants will understand the hardship withdrawal requirements as construed by MSRS.

## 2. ONGOING SERVICE TO PLAN PARTICIPANTS

<u>TASKS</u>

A. Assist with changes in amounts, investment allocations, and transfers. Answer questions regarding account balances and investment allocations.

B. Update participants on the performance history and investment philosophy of all investment options.

C. Continue to monitor that IRS and plan guidelines are followed by each participant.

D. When appropriate, inform participants of catch-up provisions and calculate the maximum amount eligible for catch-up provision.

E. Send letter, application, business reply return envelope, and other pertinent information to participants to facilitate deferral changes and investment option changes.

F. Maintain current data base information on each participant. The data base information should include: name, social security number, date of birth, address, employer, payroll cycle, current investment allocation, current contribution amount, current salary, identification of participants using catch-up provision, date of most recent application and effective pay date of most recent application. And, with the cooperation of investment providers, beneficiary designation(s).

G. Conduct group and individual meetings to continue education of deferred compensation participants.

H. Respond to written and phone requests to answer questions.

I. Process investment and deferral changes. Interact with payroll departments and investment providers to ensure accurate placement and amounts of deferrals.

J. Projections of future accumulations will be provided if requested.

<u>INDICATORS</u>

1. Field representatives will conduct group and individual meetings once or twice each calendar year in each governmental subdivision or at various locations for larger governmental units, unless otherwise requested by employer. Presentation level will be geared to knowledge of participants.

2. A toll free phone number will be maintained and almost all calls will be returned the same business day. Calls not returned the same day, must be returned the next working day.

3. Requests for brochures or other information will be mailed no later than three working days of the initial request Account balances, investment allocations, and other questions that could be answered by phone will be completed the same working day if possible, but no later than the next working day.

4. Exceeding maximum 457 limits is not permissible. Excess contributions should be minimized and returned under plan guidelines.

5. Participants should be informed of catch-up provision prior to reaching age 50. Individuals utilizing the catch-up provision will be monitored to make sure catch-up does not extend beyond three-year period.

6. Each individual will be sent a letter each year with a form and business reply envelope to allow for a change in deferral and investment options. This can be incorporated with mailing of statements if possible.

7. Age-specific investment strategies will be developed by MSRS and sent to participants at least once every two years. All participants will receive standardized rate of return newsletter.

8. Projections of future accumulations will be mailed promptly, but no later than one week after requested. Projections should be based on a reasonable rate of return and should be slightly conservative. Disclaimers are required on all estimates.

9. All financial planning and investment information must be approved by MSRS and will contain disclaimers. Material must include disclaimers clarifying that service representatives are not certified financial planners.

10. Deferral or investment changes will be made during the next appropriate payroll cycle. Transfers from one investment product to another will be made no later than the next working day or next available investment cycle.

**3. PRE-RETIREMENT TERMINATION**

<u>TASKS</u>

A. Provide and assist with forms for withdrawal of funds.

B. Explain general tax implications of lump-sum withdrawal.

C. When applicable, assist with designation of payout date.

D. Forward payout election forms to appropriate investment provider and keep records necessary to verify payment.

E. Assist in processing emergency withdrawal requests.

   a. Explain acceptable reasons for hardship withdrawals and restrictions of future deferrals.

b. Assist in completion of forms and submit to MSRS for approval.

c. Send approval letter to appropriate investment provider.

d. Follow-up to make sure check is processed in a timely manner.

F. Assist in processing death claims. Send letter to beneficiary, meet with beneficiary if appropriate, and assist in establishing payout. Notify investment providers of payout selection.

INDICATORS

1. Participants will be mailed withdrawal forms within two working days of request.

2. All brochures explaining withdrawal and payout options will include general tax implication information. Withholding forms will be provided.

3. Employees not withdrawing funds at termination will designate a payout date in compliance with IRS regulations if notified of termination date.

4. Hardship withdrawal forms will be mailed no later than the next working day after requested.

5. Investment providers will be notified of hardship approval within one working day of receipt of MSRS approval documentation.

6. Participant deductions will be stopped for a one-year period for approved emergency withdrawals. Exception for minimum contribution required to achieve employer matching contributions.

7. Mail letter and information to beneficiary within one week of being notified of participant's death.

**4. RETIREMENT**

TASKS

A. Send letter to those who are nearing retirement, or have separated from service, regarding payout information and IRS regulations on designating a payout date.

B. Explain catch-up provision to eligible participants.

C. Explain various payout options and provide estimates of the various fund alternatives.

D. Conduct group pre-retirement seminars as requested by employers and have field representative available for individual counseling.

E. Continue to provide age-specific, general investment strategies as developed by MSRS.

F. Notify payroll department to stop participant's deductions.

G. Assist in completion of proper payout forms and forward to appropriate investment provider. Maintain adequate records to verify payout information.

H. Respond to questions regarding on-going payments.

I. Explain tax withholding options on the various payout options.

J. Assist in completion of direct deposit forms.

K. Maintain record of selected future payout dates, and notify participants when approaching the designated date.

INDICATORS

1. Requests for payout information will be responded to within one week. Payout options from all providers will be explained.

2. Catch-up provision will be monitored to make sure maximums are not exceeded.

3. A letter explaining IRS distribution rules, payout options, and offering to calculate estimated payout options will be mailed to participants at age 55 and at least every other year thereafter.

4. Payout election forms will be sent to each participant at least two months prior to retirement or payout date - sooner if requested by participant.

5. All participants will be contacted one month prior to declared payout date if application is not submitted. If after one follow-up letter to the participant, the application is not received, the service organization will send a registered letter to the last known address of the participant explaining IRS distribution rules and requirements.

6. Phone and written requests from participants on payout status will be responded to within one working day.

7. Participants nearing retirement will be given an opportunity to meet with a field representative to discuss payout information at least once a year.

## 5. SERVICES PROVIDED TO EMPLOYERS

TASKS

A. Provide an updated employer handbook explaining the administrative requirements of the plan.

B. Respond to questions regarding reporting requirements, IRS rules, etc.

C. Prepare participation reports if requested by the employer

D. Assist payroll department to complete special one-time contributions or handle unusual circumstances.

E. Provide updated brochures and forms to employers.

F. Provide employers with total Plan assets as required by auditors if available.

G. Answer general tax reporting questions.

INDICATORS

1. Employer reporting handbook will be updated annually.

2. Each payroll/personnel director will be contacted yearly to ask for any questions or concerns and to determine if additional forms or meetings are needed.

3. Employer requested reports will be completed at a mutually agreeable deadline.

4. One-time deductions will be processed for the pay date specified on the application.

5. Written and phone requests will be responded to within two working days.

6. Payroll errors will be corrected by the next appropriate payroll cycle.

7. Asset information required by the auditor will be provided in a timely manner to facilitate completion of the audit report.

## 6. ADDITIONAL SERVICES

TASKS

A. Develop and design new plan forms to improve existing forms or to incorporate changes.

B. Provide business reply envelope for all forms that should or can be returned.

C. Process one-time contributions as allowed by employment contract or plan regulations.

D. Provide information to employers regarding matching employer contributions. Be available as resource to assist employer in publicizing matching program. The following services should be provided after implementation of the employer matching contribution:

   a. Send letter to all eligible employees if requested by employer.

   b. Conduct group and individual presentations as requested by the employer.

   c. Maintain statistical information to measure the success of matching program.

   d. Assist employer in writing articles in publications announcing the matching program.

E. Assist in correcting errors made by MSRS, marketers, investment providers, or payroll clerks.

F. Suggest changes to improve the Plan. The proposed changes could include, but should not be limited to, administrative, products, materials, and Plan rules.

G. Help determine the impact of new state and federal laws that may affect the plan.

H. Prepare reports as requested by MSRS.

## INDICATORS

1. Forms will be reviewed at least annually to make sure forms are current. All forms must be approved by MSRS.

2. One-time contributions must be processed during the next available payroll cycle.

3. Group and individual meetings will be conducted when initiating an employer matching program.

4. Attempts to correct errors will be started within one working day of identifying the error.

5. Recommendations for changes or not making changes regarding item "F" above will be submitted each January. Requests for input on any proposed federal and state law changes will be submitted in writing within two working days after being advised of proposed federal and state law changes unless otherwise agreed upon by the Executive Director.

6. Reports requested by MSRS will be submitted within a mutually agreeable time frame.

## STAFF TRAINING AND EDUCATION

Continued training and education is important to make sure each representative is familiar with all aspects of the Minnesota State Deferred Compensation Plan. Training should, at a minimum, include 15 hours of approved continuing education each year. Annual or semi-annual meetings should be conducted with all representatives to keep abreast of Plan rules and current trends.

All agents should have the following licenses:

Life/Accident Health Insurance
Series 63, Blue Sky Laws
Series 6

Agents shall be licensed to sell all insurance products if current arrangement is modified to equally market all products.

The marketing organization should maintain membership in the National Association of Government Deferred Compensation Administrators.