



STATE OF WISCONSIN  
Department of Employee Trust Funds  
Robert J. Conlin  
SECRETARY

801 W Badger Road  
PO Box 7931  
Madison WI 53707-7931  
  
1-877-533-5020 (toll free)  
Fax (608) 267-4549  
<http://etf.wi.gov>

**CORRESPONDENCE / MEMORANDUM**

**DATE:** February 3, 2014  
**TO:** Deferred Compensation Board Investment Committee Members  
**FROM:** Shelly Schueller  
Deferred Compensation Director  
**SUBJECT:** Investment Option Benchmark Review

Bill Thornton from Advised Assets Group (AAG) recently completed an analysis of the benchmarks used by the Wisconsin Deferred Compensation Program (WDC) to evaluate the performance of the WDC's investment options.

The Board's Investment Policy Statement, which is attached to this memo, states that performance benchmarks will be "established for each investment option and include a comparison to their peer group average, an appropriate index measurement, and an internal benchmark identified by the fund manager. ... Performance must meet or exceed one or more of established benchmarks – benchmarks used include, but are not limited to 1) peer group average, 2) appropriate index as determined by Board, and 3) internal benchmark assigned by fund manager."

The attached review provides an outline of the existing benchmarks. It also recommends possible revisions to the benchmarks that, if implemented, would improve the consistency of the benchmarking and consequently provide a better indication of WDC investment option performance relative to the funds' appropriate indices and peer funds.

AAG will be available at the February 13, 2014, meeting to discuss the suggested changes with the committee.

Attachments: Wisconsin Deferred Compensation Program Investment Policy Statement  
Wisconsin Deferred Compensation Program Investment Option  
Benchmark Review, February 2014

Reviewed and approved by Matt Stohr, Administrator, Division of Retirement Services

Electronically Signed 2/05/14

Board	Mtg Date	Item #
DCIC	2.13.14	2

**Wisconsin Deferred Compensation Program**  
**Deferred Compensation Board**  
**Investment Policy Statement**

Approved: November 1998

Revised: February 2005

***Objective***

The Wisconsin Deferred Compensation Program (WDC) will provide participants with the ability to invest pre-tax income in a broad range of investment alternatives with diverse risk and return characteristics. The Deferred Compensation Board's goal is to ensure the WDC offers sufficient investment choices to meet participants' needs when establishing their personal retirement savings portfolio.

***Investment Spectrum***

The Board will maintain a core investment spectrum, normally between eight and twenty options, to ensure sufficient choices are available and are reasonable in number to allow the average participant to decide which options best meet their personal needs. The spectrum will be comprised of fixed options and publicly traded mutual fund options from the following categories:

1. Fixed income/cash investments: FDIC-insured bank account option, stable value fund, or money market mutual fund.
2. Bond mutual funds: government or corporate bond funds, domestic or international, active or passive management.
3. Balanced mutual fund: combining equity and bond investments in one option.
4. Domestic large cap equity mutual funds: including both active and passive (index) investments; funds with investment objectives that may include: growth and income, growth, aggressive growth, value, and blend of growth and value.
5. Domestic small and mid-cap equity mutual funds: growth, value or blend.
6. International or foreign equity mutual funds: growth, value or blend.
7. Lifecycle funds: age-based portfolios for multiple time horizons.

***Selection Process***

The Board may from time to time provide additional investment alternatives and may change the categories of funds offered to maintain a broad spectrum to address participants' changing needs or changes to the investment industry. The Board has established minimum criteria for selecting and evaluating the options offered by the WDC.

Mutual fund options are selected from the universe of publicly traded funds through a comprehensive search process. For an option to be considered for the WDC, it must

*meet* the established minimum requirements in regard to: asset size, years in operation, costs (expense ratio and sales fees), and historical performance. Once the initial screening has occurred, options are further analyzed based on criteria that includes, but is not limited to: short and long term performance as compared to peer group average and benchmarks, risk/return measurements, manager tenure, and industry ratings (such as *Morningstar*). Fixed income investments must also meet minimum criteria established by the Board (see attachment 1) and are selected from a competitive request for proposal process.

### ***Evaluation Process***

To ensure options continue to be suitable for offering to WDC participants and are consistent with the established investment policy, the Board completes a comprehensive evaluation each year.

Performance benchmarks are specifically established for each investment option and include a comparison to their peer group average, an appropriate index measurement, and an internal benchmark identified by the fund manager. Volatility is also measured by an analysis of risk versus return.

If the Board determines an option is no longer acceptable for continued offering, the Board may close the investment to new participant elections or initiate the process to phase the option out of the WDC and require participants to move account balances to an alternate choice. The steps in the review process are as follows:

1. A determination is made that a fund is unacceptable for offering. The Board can either close the fund to new elections and proceed with step 2, or initiate the phase out process to remove the fund from the WDC and skip step 2 and 3 and go directly to step 4.
2. As a result of the next year's annual review, if it is determined to once again be acceptable, the fund is re-opened to participant elections.
3. If improvements have occurred but it is not completely meeting all established criteria and/or there are remaining questions about its performance in can be continued in its current closed status for an additional year.
4. If the review demonstrates that the fund continues to be unacceptable for offering, the Board can initiate the process to phase it out of the WDC over a minimum of a one-year period (as required in Wisconsin Administrative Code ETF 70.08(3)).
5. Participants are instructed to re-direct deferrals to an alternate choice within a period of not less than six-months from the original notification. If this action is not taken, deferrals being directed into the option being removed will automatically be redirected to an alternate option as designated by the Board.

6. Participants are instructed to transfer existing balances to an alternate choice within a period of not less than one year from the original notification. If this action is not taken, account balances not exchanged out of the option being removed will automatically be redirected to an alternate option as designated by the Board.

### ***Responsibilities***

**Deferred Compensation Board** – The Board is responsible for selecting appropriate investment options for offering by the WDC and monitoring the selections to ensure they continue to be acceptable for long-term retirement savings.

**Investment Providers** – The companies contracted to provide an investment option to the WDC are responsible for following the investment objectives that were either identified during the competitive bid process (for fixed income options) or stated in their fund prospectus (for mutual funds).

**Department of Employee Trust Funds and Administrative Services Provider Staff** – Staff is responsible for completing the annual evaluation to monitor the WDC investment choices and providing sufficient analysis and information on which the Board can base decisions regarding maintaining, removing or adding investment options to the WDC. Staff is also responsible for providing sufficient information about the available investment choices and how to structure a retirement savings portfolio to enable participants to make informed decisions.

**Participants** – Investment decisions are the full responsibility of participants and their beneficiaries. Although the Board monitors the options that are being made available, participants are responsible for deciding which, if any, of the available choices are the most appropriate for their supplemental retirement savings needs.

**Attachment 1**

<b>Minimum Criteria for Selecting and Evaluating Fixed Income Options</b>	
Bank Option	<ul style="list-style-type: none"> <li>• FDIC insured</li> <li>• Capital ratio as required by US government to maintain FDIC coverage</li> <li>• Minimum size - \$1 billion in assets</li> </ul>
Insurance Option	<ul style="list-style-type: none"> <li>• Top rating received by at least <b>2 rating agencies</b></li> <li>• No rating below a Double A or equivalent</li> <li>• Total capital (equivalent to total assets minus total liabilities) equal to at least 5% of invested assets</li> <li>• High risk assets (non-investment grade bonds and non-performing real estate loans and investments) under 200% of total capital</li> <li>• Performance returns compared to blended 5-year Treasury rates, or other index as appropriate</li> </ul>
Stable Value Fund Manager	<ul style="list-style-type: none"> <li>• Minimum five years experience managing stable value assets</li> <li>• Minimum \$2 billion in discretionary assets under management</li> <li>• Investment guidelines and performance benchmark as approved by Board</li> </ul>
<b>Minimum Criteria for Selecting and Evaluating Mutual Fund Options</b>	
<b>Selection Criteria:</b> <i>Requirements apply to all mutual funds unless specifically waived</i>	<ul style="list-style-type: none"> <li>• Minimum 5 year operating history – may be waived for index funds</li> <li>• Expense ratio [internal expense charge plus any 12(b)1 fee] not greater than the mean for the appropriate peer group</li> <li>• 5-year rolling average performance must equal or exceed appropriate benchmark or index</li> <li>• Minimum total asset size of \$400 million – may be waived for certain categories of funds</li> <li>• Anticipated WDC assets not greater than 5% of total fund (determined by comparing current WDC asset levels in a comparable fund)</li> <li>• No loads or sales charges unless they are waived for the WDC</li> <li>• Not a sector fund</li> </ul>
<b>Monitoring Criteria:</b> <i>Requirements apply to all mutual funds unless specifically waived</i>	<ul style="list-style-type: none"> <li>• Performance must meet or exceed one or more of established benchmarks – benchmarks used include, but are not limited to 1) peer group average, 2) appropriate index as determined by Board, and 3) internal benchmark assigned by fund manager.</li> <li>• For specialty funds selected for reasons other than performance (e.g., socially responsive funds or lifecycle funds), performance will only be evaluated based on a comparison to the funds peer group of funds with same specialty objective. [Participants will be fully advised that fund is selected for reasons other than investment returns.]</li> <li>• WDC assets in fund no greater than 10% of the total mutual fund assets</li> <li>• After 5 years in WDC, minimum of 3% of participants or 3% of assets.</li> </ul>



ADVISED ASSETS  
GROUP

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# Wisconsin Deferred Compensation Program Investment Option Benchmark Review

*February, 2014*





## Current Policy and Benchmarks

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## Wisconsin Deferred Compensation Program

# Investment Policy Criteria

### Monitoring Criteria:

- Performance must meet or exceed one of more of established benchmarks – benchmarks used include, but are not limited to:
  1. Peer group average
  2. Appropriate index as determined by Board
  3. Internal benchmark assigned by fund manager
- For specialty funds selected for reasons other than performance (e.g., socially responsive funds or lifecycle funds), performance will only be evaluated based on a comparison to the funds peer group of funds with same specialty objective. [Participants will be fully advised that the fund is selected for reasons other than investment returns]
- WDC assets in fund no greater than 10% of the total mutual fund assets.
- After 5 years in WDC, minimum of 3% of participants or 3% of assets.



# Current Investment Option Benchmarks

## Index Fund Benchmarks

### Investment Product

### 2010 Performance Benchmarks

Blackrock EAFE Equity Index Fund

1 MSCI EAFE\*

Blackrock Small Cap Equity Index Fund

1 Russell 2000 Index\*

Blackrock MidCap Equity Index Fund

1 S&P MidCap 400 Index\*

Vanguard Institutional Index Fund (Plus Shares)

1 S&P 500 Index\*

Blackrock U.S. Debt Index Fund

1 BarCap Aggregate Index\*

\* *Represent benchmarks used by the fund.*

\*\* *Represent benchmarks used by the Board.*

## Wisconsin Deferred Compensation Program

# Current Investment Option Benchmarks

## Active Equity Fund Benchmarks

### Investment Product

American Funds EuroPacific Growth R6

DFA U.S. Microcap Portfolio

T. Rowe Price MidCap Growth Fund

Calvert Social Investment Equity Fund- Institutional Class

Fidelity Contrafund

### 2010 Performance Benchmarks

- 1 MSCI EAFE Free Index\*
- 2 Lipper International Funds Average\*
- 3 MSCI All Country World Index ex-USA\*
- 4 Morningstar Foreign Large Cap Blend Category Average\*\*

- 1 Russell 2000 Index\*
- 2 Russell Microcap Index\*\*

- 1 Lipper Mid Cap Growth Funds Average\*
- 2 Russell Mid Cap Growth Index\*
- 3 S&P 400 Mid Cap Index\*
- 4 Morningstar Mid Cap Growth Category Average\*\*

- 1 S&P 500 Index\*
- 2 Lipper Multi-Cap Core Funds Average\*
- 3 Calvert Social Index\*\*
- 4 Morningstar Socially Responsible Large Cap Fund Average\*\*

- 1 S&P 500 Index\*
- 2 Lipper Growth Fund Average\*
- 3 Morningstar Large Growth Category Average\*\*

\* Represent benchmarks used by the fund.

\*\* Represent benchmarks used by the Board.

## Wisconsin Deferred Compensation Program

# Current Investment Option Benchmarks

## Active Fixed Income / Cash Fund Benchmarks

### Investment Product

### 2010 Performance Benchmarks

Vanguard Long-Term Investment Grade-Fund (Admiral Shares)

1 BarCap LT Corporate A\*  
2 Morningstar LT Corporate Category Average\*\*

Federated U.S. Government Securities Fund 2-5 Years (Instl)

1 Merrill Lynch 3-5 Year Treasure Index\*  
2 Lipper Short-Intermediate U.S. Government Average\*  
3 Morningstar Short-term Government Category\*\*

Vanguard Admiral Treasury Money Market Fund

1 iMoneyNet Money Fund Report Avg 100% Treas Fund\*

Stable Value Fund (Galliard)

1 Five Year Constant Maturity Treasury Rate (CMT)\*  
2 Hueler Analytics Pooled Fund Universe Average\*

FDIC Option- M&I Bank of Southern Wisconsin

1 50% 3-Month LIBOR / 50% 12-Month LIBOR

\* *Represent benchmarks used by the fund.*

\*\* *Represent benchmarks used by the Board.*

## Wisconsin Deferred Compensation Program

# Current Investment Option Benchmarks

## Allocation Fund Benchmarks

### Investment Product

Vanguard Wellington Fund (Admiral Shares)

Vanguard Lifecycle Funds

### 2010 Performance Benchmarks

- 1 Lipper Balanced
- 2 Morningstar Moderate Allocation Funds Average\*\*
- 3 Composite 65% S&P 500/35% Lehman Aggregate Index\*\*

- 1 Composite benchmarks based on asset allocation of funds\*\*
- 2 Dow Jones U.S. Target Date Indexes\*\*

\* Represent benchmarks used by the fund.

\*\* Represent benchmarks used by the Board.



## Suggested Benchmarks

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## Wisconsin Deferred Compensation Program

# Suggested Investment Option Benchmarks

## Active Equity Fund Benchmarks

<u>Investment Product</u>	<u>Peer Group Benchmark</u>	<u>Market Benchmark</u>	<u>Fund Family Benchmark</u>
American Funds EuroPacific Growth R6	Morningstar Foreign Large Blend Avg	MSCI EAFE Index	MSCI ACWI ex U.S.
DFA U.S. Microcap Portfolio	Morningstar Small Cap Growth Avg	Russell 2000 Index	Russell 2000 Index
T. Rowe Price MidCap Growth Fund	Morningstar Mid Cap Growth Avg	Russell Mid Cap Growth Index	S&P Midcap 400 Index
Calvert Social Investment Equity Fund- Instl	Morningstar Large Cap Growth Avg	Morningstar Socially Resp Large Cap Avg*	S&P 500 Index
Fidelity Contrafund	Morningstar Large Cap Growth Avg	Russell 1000 Growth Index	S&P 500 Index

\* Per IPS, Specialty funds are compared only to peers.

## Wisconsin Deferred Compensation Program

# Suggested Investment Option Benchmarks

## Active Fixed Income / Cash Fund Benchmarks

<u>Investment Product</u>	<u>Peer Group Benchmark</u>	<u>Market Benchmark</u>	<u>Fund Family Benchmark</u>
Vanguard Long-Term Inv Grade-Fund Adm	Morningstar Corporate Bond Avg	Barclay's LT Corporate A	Barclay's LT Corporate A
Federated U.S. Govt Secs Fund 2-5 Years Instl	Morningstar Short Government Avg	Barclay's US Treas/Agency 3-5 Yr	BofA Merrill Lynch US Treas 3-5 Yr
Vanguard Admiral Treasury Money Market Fund	Morningstar Taxable Money Mkt Avg	U.S. Treasury 90-Day T-Bill	iMoneyNet Money Fund Avg 100% Treas Fund*
Stable Value Fund (Galliard)	Hueler Analytics Pooled Fund Universe Avg	Five Year Constant Maturity Treas Rate	
FDIC Option- M&I Bank of Southern Wisconsin	Morningstar Taxable Money Mkt Avg	50% 3-Month LIBOR / 50% 12-Month LIBOR	

## Wisconsin Deferred Compensation Program

# Suggested Investment Option Benchmarks

## Allocation Fund Benchmarks

<u>Investment Product</u>	<u>Peer Group Benchmark</u>	<u>Market Benchmark</u>	<u>Fund Family Benchmark</u>
Vanguard Wellington Fund (Admiral Shares)	Morningstar Moderate Allocation Avg	Composite 65% S&P 500 / 35% Barclay's Agg Index	Composite 65% S&P 500 / 35% Barclay's U.S. Credit A or Better Idx
Vanguard Lifecycle Funds	S&P Target Date Indexes	-*	Composite Index**

\* Per IPS, lifecycle funds are compared only to peers.

\*\* Vanguard uses a variety of market indices to benchmark their target date funds.



## Wisconsin Deferred Compensation Program

# Suggested Investment Option Benchmarks

## Target Date Fund Benchmarks

Performance comparisons between target date fund families are largely driven by the asset allocation (glide path) of the funds.

Absolute Differences in Equity Exposure Among Index GlidePaths						
	<u>Vanguard</u>	Morningstar LifeTime <u>Aggressive</u>	Morningstar LifeTime <u>Moderate</u>	Morningstar LifeTime <u>Conservative</u>	Dow Jones U.S. <u>Target Date</u>	S&P <u>Target Date</u>
Target Year 2015	52.28	9.92	6.54	23.04	20.49	3.00
Target Year 2025	68.92	11.70	5.29	26.86	13.73	3.73
Target Year 2035	83.73	7.28	1.53	20.44	6.39	6.09
Target Year 2045	89.02	2.75	1.65	11.84	0.52	3.41
Target Year 2055	88.17	3.35	0.53	8.44	2.13	1.79
Retirement Income	29.64	14.45	2.59	10.65	21.64	0.74
	Average	8.24	<b>3.02</b>	16.88	10.82	<b>3.13</b>

Source: Morningstar Direct and DJIndexes.com