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CORRESPONDENCE / MEMORANDUM

DATE: May 14, 2014

TO: Deferred Compensation Board

FROM: Robert C. Willett, CPA, Chief Trust Financial Officer
Shelly Schueller, Deferred Compensation Director

SUBJECT: Share Class Review

The Deferred Compensation Board (Board) is asked to consider approving a change from the retail share class to the institutional share class of the T. Rowe Price MidCap Growth Fund.

After the fiduciary training provided by Great-West Financial at the Board's March 2014 meeting, the Board requested confirmation from the Wisconsin Deferred Compensation Program (WDC)'s investment providers that the WDC is offering the lowest possible cost options. The information in this memo provides information on four WDC investments with opportunities to potentially lower costs via alternative share classes or other means, and a recommendation to change to a lower-cost share class for the T. Rowe Price MidCap Growth Fund.

1. Fidelity Contrafund

The current share class expense ratio for the Fidelity Contrafund is 0.74, with a plan sponsor reimbursement of 0.25 for plan expenses. When taking into account the reimbursement, the net fee for Fidelity Contrafund is 0.49. Over the last three years, the Board has received an average of $1,015,290 per year from Fidelity, which the Board has used to help offset administrative fees for plan participants.

As of late March 2014, Fidelity's Board opened share class "K" to plan sponsors who can meet Fidelity's minimum investment requirements. The WDC meets the Fidelity minimums and thus is eligible to offer the new share class. The expense ratio for the newly available share class ("K") is 0.63, with no plan sponsor reimbursement.

Recommendation for Fidelity Contrafund: Staff recommend no changes at this time regarding this investment option. The slightly lower cost of the new "K" share class does not translate to enough savings for WDC participants when compared to the overall loss of the Fidelity plan expense reimbursement. Changing share classes would negatively affect participant administrative fees, perhaps requiring an immediate increase of approximately fifty percent (50%).

Reviewed and approved by Robert J. Conlin, Secretary

Electronically Signed 5/19/14

Board	Mtg Date	Item #
DC	6.3.14	9A

2. Stable Value

The Board currently offers the Stable Value Fund (SVF) as a separate account vehicle. Galliard Capital Management, which operates the WDC's SVF, confirmed the current format of the SVF is the most inexpensive way to offer an SVF. The fee for the WDC's SVF is approximately 0.386, which Galliard states is similar to what the other comparable multi-manager stable value clients are paying.

The Board could change management of the SVF to an "all Galliard" approach. If the SVF were moved to an "all Galliard" fixed income approach, then it would be possible to lower the cost of the SVF. Galliard estimates the overall fee reduction would be about 0.09 (9 basis points) from the current level, from approximately 0.386 to around 0.300.

When the Board first contracted with Galliard for a SVF in 1998, the Board chose to provide some style diversification through the use of a multi-manager approach. However, this comes at a price -- the external manager fee schedules are additive and there is an additional cost for the added oversight required for the external managers. The multi-manager approach has worked well for the WDC as is apparent in the overall returns to the participants.

<u>Recommendation for SVF</u>: No change. The current multi-manager approach is a good diversification tool within the SVF and should be maintained.

3. **T. Rowe Price MidCap Equity Growth**

The current share class expense ratio for the T. Rowe Price MidCap Equity Growth Fund (TRP MCG) is 0.80, with an administrative fee payment (reimbursement) for plan sponsors of 0.15 for plan expenses. When taking into account the 0.15 reimbursement, the net fee for the TRP MCG is 0.65. Over the last three years, the Board has received an average of $405,242 per year from T. Rowe Price, which is used to help offset participant administrative fees.

The TRP MCG also has an institutional share class (ticker symbol PMEGX) which has an expense ratio of 0.62. This version does not offer the 0.15 reimbursement that the Board currently receives. Both the fund currently offered by the WDC and the institutional version are managed by the same portfolio manager and are meant to be clones of each other. If this option were to be moved to the institutional share class of the TRP MCG fund, it would require approval from a senior management committee within T. Rowe Price.

<u>Recommendation for T. Rowe Price MCG:</u> Change from the retail share class to the institutional share class for the TRP MCG fund. The institutional share class translates to lower cost for participants in the fund, and per the May 2014 participant fee analysis, the institutional share class can be utilized by the WDC without requiring an increase in participant administrative fees.

4. Vanguard Target Date Funds

Vanguard responded to staff's query regarding share classes and fees by stating that if the WDC could demonstrate to Vanguard that the WDC is a qualified plan per the IRS (likely via a letter of determination), then the WDC would be eligible to convert its existing Vanguard Target Retirement Date Funds to commingled trusts. The primary advantage of commingled trusts is lower expense ratios. Vanguard stated that management fees for the commingled trusts are usually negotiable, depending on trust structure. The Vanguard Target Retirement Date Funds offered through the WDC have expense ratios ranging from 0.16 to .018. If the WDC's Target Retirement Date funds were converted to commingled trusts, the expense ratios could drop to around 0.083.

Like mutual funds, commingled or collective trusts have specific investment objectives, may purchase stocks and bonds, etc., and are offered through investment managers. Commingled trusts frequently have lower expense ratios and fewer administrative requirements than mutual funds. For example, commingled trusts do not have to produce a prospectus, nor do they have to comply with federal Securities and Exchange Commission regulations. However, commingled trusts do not trade publicly, so transparency is lost. Investors cannot simply look up the fund via a ticker symbol. Although moving to commingled trusts would eliminate some transparency, as participants cannot track commingled trusts via a ticker symbol, the tradeoff for lower cost seems appealing.

Note: Currently, the WDC offers four BlackRock commingled trusts. These trusts mimic specific indices and were specifically added to the investment lineup between 2001 and 2004 to provide alternatives to the WDC's actively-managed funds in selected categories. The expense ratios for the BlackRock options are very low--from 0.04 to .010. The WDC was able to secure these low expense ratios because the investment provider took into account the broader relationship with the State of Wisconsin Investment Board (SWIB) when entering into an agreement to offer these commingled trusts to WDC participants.

<u>Recommendation for Vanguard Target Date Funds:</u> No change is possible unless the Board can provide Vanguard with appropriate documentation illustrating the WDC is a properly qualified plan. It does not seem likely that the IRS will change the status of s. 457 plans such as the WDC from an unqualified to a qualified plan.

Recommendation

After research and careful review of the options and share classes available, staff proposes the Board make a change to one investment option. The WDC should offer the lower-cost institutional share class of the T. Rowe Price MidCap Growth Fund share class, instead of the more expensive retail share class now offered to participants.

Staff will be available at the Board meeting to discuss this memo and answer any questions.