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CORRESPONDENCE / MEMORANDUM

DATE: August 15, 2014

TO: Deferred Compensation Board Investment Committee

FROM: Shelly Schueller, Deferred Compensation Director
Bob Willett, Chief Trust Financial Officer
Dan Hayes/David Nispel, ETF Legal Counsel

SUBJECT: Allocation of WDC Investment Option Reimbursements

This memo provides information about the reimbursements allocation questions that the Deferred Compensation Board (Board) may be asked to address. It includes data on how other plan sponsors utilize reimbursements from the investment options with higher share classes that provide reimbursements. In addition, we have included a recommendation for the Investment Committee's consideration regarding future usage of reimbursements.

Background

The Wisconsin Deferred Compensation Plan (WDC) does not receive funding from the state or participating employers to pay for the WDC. Revenues to pay for WDC expenses come from reimbursements, annual administrative fees paid by participants and any gains (income) on the Board's administrative account balance. As of August 22, 2014, two mutual fund options offered by the WDC provide a reimbursement to the Board. In addition, the firms offering two of the fixed options (the Stable Value Fund and the FDIC Option) provide the Board with a small reimbursement. The reimbursement is in proportion to their share of marketing expenses based on assets in their option as of the close of the calendar year – contractually, these reimbursements may not exceed $5,000 per year. As shown in Table 1, these reimbursements are very small.

One mutual fund, Fidelity ContraFund, recently opened a retail share class option to the WDC that offers a slightly lower expense ratio, but with no reimbursement.

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

Matt Stohr

Electronically Signed 8/21/14

Board	Mtg Date	Item #
DCIC	9.11.14	2B

Reimbursements received by the Board from the investment options are deposited in the Board's administrative account, from which the WDC's administrative expenses are paid. The Board seeks to keep a reserve balance equal to approximately half of annual plan expenses.

Table 1: WDC Investment Options Providing Reimbursements

WDC Investment Option	# using as of 6/30/14	Expense Ratio	Reimb.	3 Year Average Annual Board Reimbursement	Is Lower Cost Available?	If Yes, Lower Cost Exp. Ratio
FDIC	3,259	---	---	$580	No	---
Federated US Gov't Sec.: 2-5 Years	5,519	0.85	0.20	$70,415	No	---
Fidelity ContraFund	21,118	0.74	0.25	$1,015,290	*Yes*	0.63
Stable Value	20,410	---	---	$3,521	No	---

The reimbursements have helped the Board keep WDC participant administrative fees low. Annual participant fees, in effect since January 1, 2008, are below.

Table 2: WDC Participant Administrative Fees

Participant Account Balance	Monthly/Annual Fee
$1-$5,000	$0/$0
$5,001-$25,000	$1/$12
$25,001-$50,000	$2/$24
$50,001-$100,000	$4/$48
$100,001+	$5.50/$66

<u>Options for Plan Sponsor Allocation of Reimbursements</u>

1. Retaining reimbursements and using them to pay general plan expenses;
2. Retaining reimbursements for paying general plan expenses, but also offsetting participant fees with a "holiday" that suspends fees until the plan again needs to raise revenue to pay expenses;
3. Using reimbursements to purchase additional shares of the option generating the reimbursement for the participants in that fund; and
4. Distributing reimbursements periodically to participants, either per capita (per participant) or in proportion to their account balances (pro rata). Allocations are usually done after a balance reaches a certain amount or on a specific date.

<u>Peer Plan Allocation of Reimbursements</u>

Responses to a query posed to the National Association of Government Defined Contribution Plan Administrators (NAGDCA) in July 2014 found that 16 of 21 responding plans (76%) received reimbursements. Seven operate similar to the WDC and simply use the reimbursements for general plan expenses. Many utilize the reimbursements for overall plan expenses and distribute any surplus revenue after expenses to their participants. A few have offered “fee holidays” that suspend participant administrative fee collection for a period of time. At least two plans use the reimbursements to purchase additional shares of the option providing the reimbursement for benefit of the participants in that fund.

Unless reimbursements are returned to the participants whose balances created the reimbursement, the Board’s current use of reimbursements could be seen as inequitable; some participants’ investment choices (those that provide a reimbursement) are subsidizing the expenses of other participants in the plan. Returning the reimbursements to the participants whose balances created the reimbursement ensures that all participants are paying a similar proportion of the plan’s administrative costs based on their account balance in each of the plan’s funds.

Recommendation
Staff suggests that the Investment Committee recommend the following to the Board:

1) Adopting a policy that would provide periodic rebates to participants using the options providing the reimbursements, as long as a minimum balance is maintained in the Board’s administrative expense account to cover operating expenses. This proposal could be presented at the next Board meeting, along with projections on when this might be accomplished with the least disruption to the existing participant administrative fee structure.
2) Eliminating the FDIC and Stable Value Fund contract provisions that require the small reimbursements to the Board. The reimbursements received are very small and it would not be cost effective to reimburse participants the very fractional amounts for which they would be eligible. It would be cleaner to simply eliminate the reimbursements altogether.

Staff will be at the September 11, 2014, meeting, to discuss this memo and answer any questions you may have on the contents.