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**CORRESPONDENCE / MEMORANDUM**

**DATE:** August 12, 2014  
**TO:** Deferred Compensation Board Investment Committee  
**FROM:** Shelly Schueller, Director  
Wisconsin Deferred Compensation Program  
**SUBJECT:** Investment Policy Statement Review

**Staff proposes that the Committee recommends that the Board revise the Investment Policy Statement.**

The Deferred Compensation Board (Board) established policies for selecting and monitoring investment options shortly after the Board's creation in 1989. These policies were updated and formalized in 1998 as the Board's *Investment Policy Statement (IPS)*. The IPS outlines the Board's objectives when deciding which investment options should be offered by the Wisconsin Deferred Compensation Program (WDC), the general composition of the investment spectrum, the process for selecting and monitoring options, and the responsibilities for all parties that are involved, including participants.

The IPS has not been revised since 2005, when lifecycle funds (a.k.a., target date funds) were added to the WDC. Department staff recommends the Board consider revising the IPS to more accurately reflect the current investment spectrum, selection and monitoring practices. Possible revisions to the IPS are marked on the attached draft. Staff will be available at the meeting to discuss these modifications.

Attachment: Draft Investment Policy Statement with proposed revisions

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

Electronically Signed 8/21/14

Board	Mtg Date	Item #
DCIC	9.11.14	3

**Wisconsin Deferred Compensation Program**  
**Deferred Compensation Board**  
**Investment Policy Statement**  
*Approved by the Deferred Compensation Board November 1998*  
Revised February 2005  
Revised (draft) 2014

**Objective**

The Wisconsin Deferred Compensation Program (WDC) will provide participants with the ability to invest ~~pre-tax income~~ retirement savings 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.

This Investment Policy Statement (IPS) describes a prudent investment process that the Board has determined is most appropriate for the WDC. The IPS is designed to allow for sufficient flexibility in the management oversight process, while also setting forth reasonable parameters to promote the exercise of reasonable prudence and care with respect to the investment options available in the WDC. The Board may amend the IPS from time to time, as it deems advisable.

**Investment Spectrum**

The Board recognizes that there is investment risk inherent in all investment options, and that individual participants each have their own level of risk tolerance. Accordingly, the Board will select and offer a broad array of investment options providing different levels of risk and historical return, and other financial characteristics as appropriate. 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, and institutional investment products (examples: separate accounts, commingled trusts) 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 funds – 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, and active or passive management.*
5. *Domestic small and ~~mid-cap~~ mid-cap equity mutual funds – growth, value or blend, and active or passive management.*
6. *International or foreign equity mutual funds – growth, value or blend, and active or passive management.*

7. Lifecycle (*target date*) funds – age-based portfolios for multiple time horizons.

8. Specialty Funds – may be offered for participants interested in a particular style of investment choice. Any specialty fund offered must remain true to its special criteria (e.g., socially responsible) and competitive to its specific asset class.

9. Self-Directed Brokerage Account (SDBA) – will offer a wide array of mutual funds that can be accessed by participants. The investment options in the SDBA will not be monitored by the Board. Participants electing the SDBA will be required to acknowledge that they are responsible for sufficiently sophisticated and knowledgeable about investing and that they are capable of making, managing and controlling their investment choices.

### **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, as shown in Attachment 1.

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~~ Attachment 1) and are selected from a competitive request for proposal process.

### **Evaluation Process**

As required in Wisconsin Administrative Code ETF 70.08(9), ~~to~~ to ensure options continue to be suitable for offering to WDC participants and are consistent with the established investment policy statement, the Board ~~completes~~ will complete a comprehensive evaluation each year. This evaluation will be accomplished using the minimum criteria stated in Attachment 1.

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.

The Board recognizes that an investment manager's performance can move in cycles over time and that investment option performance will not always be superior. As such, the Board will generally monitor selected investment option performance on a periodic basis.

While the primary analysis of investment options will be quantitative, the Board reserves the right to make decisions regarding investment options based upon other criteria that the Board believes will be in the best interests of the WDC and its participants.

### Underperforming Investment Options

If the Board determines an option is underperforming or 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. The Board completes an investment performance review of all investment options. If an investment option is determined to be underperforming, the Board may:
  - a) Put the investment option on a formal "watch" list. While an investment option is on a "watch" list, no action will be taken to either close or replace the option. WDC participants will be informed of a "watch" decision. The investment option manager may be informed, and additional information may be gathered as to why the investment option is underperforming; or
  - b) ~~A determination is made that a fund is unacceptable for offering. The Board can either close~~ Close the investment option~~fund~~ to new elections and proceed with step 2;2; or
  - a)c) ~~Initiate~~ Initiate the phase out process to remove the investment option~~fund~~ from the WDC. If this route is chosen, steps ~~and skip~~ step 2 and 3 will be skipped; and go directly to step 4.
- 4.2. As a result of the next year's ~~annual investment performance~~ review, if ~~the option's investment performance~~ is determined to once again be acceptable, the investment option~~fund~~ may be taken off the "watch" list and if necessary because the option was closed to new elections, the option will be~~is~~ re-opened to participant elections.
- 2.3. If improvements have occurred but ~~if the investment option~~ is not completely meeting all established criteria and/or there are remaining questions about its performance, the option~~in~~ can be continued in~~on a "watch" list or continue in its current~~ closed status for an additional year.
- 3.4. If the review demonstrates that the investment option~~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)).
- 4.5. 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.
- 5.6. 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.

### Other Considerations

The Board may conduct informal reviews and evaluations of an investment option at any time. The Board may place an investment option under formal review or immediately terminate an investment option for any reason, including but not limited to the following:

1. The investment option has changed managers, or such a change appears imminent.

2. The investment option has had a significant change in ownership or control.
3. The investment option has changed its investment mandate or has experienced style drift, departing from the investment objectives or parameters in its prospectus.
4. The investment option has experienced substantial portfolio turnover.
5. The investment option has violated an SEC rule or regulation.
6. The investment option has experienced difficulty in transacting trades, fund transfers or pricing.
7. The investment option has experienced other changes or problems in its procedures, operations, investing or reporting or a lack of employee participation, which in the Board's view has detracted from our could detract from the WDC's objectives.
8. Any other circumstance regarding the investment option that the Board determines is in conflict with this IPS or may be detrimental to the WDC, such as involvement in a scandal process.

### ***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 institutional investment products) 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: Minimum Criteria for Selecting and Evaluating Investment Options

## 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 <u>and approved by Board</u></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 <u>and Institutional Investment Product</u> Options</b>	
<b>Selection Criteria:</b> <i>Requirements apply to all <del>mutual funds</del>-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 <del>mutual funds</del>-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/<u>target date</u> 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 <u>when a that</u> 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 <u>the</u> WDC, minimum of 3% of participants or 3% of assets.</li> </ul>