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: October 13, 2014

TO: Deferred Compensation Board

FROM: Shelly Schueller, Deferred Compensation Director
Bob Willett, Chief Trust Financial Officer

SUBJECT: Investment Option Selection and Reimbursements Policy

The Investment Committee and Department of Employee Trust Funds (ETF) staff recommend that the Deferred Compensation Board (Board) create a new policy on investment option selection and reimbursements that:

1) **Positively affirms the Board's desire to offer share classes that do not provide reimbursements, when a more inexpensive (e.g., institutional) share class is available and it is fiscally prudent; and**

2) **Clearly explains how and when investment option reimbursements may be allocated back to participants in the option that generated the reimbursement, including setting a minimum threshold dollar amount for when rebates will be processed from the fixed option reimbursements.**

During 2014, the Deferred Compensation Board (Board) has been discussing its fiduciary responsibilities and decisions the Board must make regarding the use of reimbursements from various Wisconsin Deferred Compensation Program (WDC) investment options.

On September 11, 2014, Investment Committee members reviewed the information on the Board's fiduciary duties that is attached to the Administrative Expense Account Investment and Target Balance Policy Update memo (Ref. DCIC | 9.11.14 | 2A). After discussion, the Investment Committee recommended that the Board develop a policy explicitly stating that the Board prefers to offer share classes that do not provide

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

Matt Stohr Electronically Signed 10/20/14

Board	Mtg Date	Item #
DC	11.4.14	10B

reimbursements, when a more inexpensive (e.g., institutional) share class is available and it is fiscally prudent to do so.

The Investment Committee recommended staff develop a policy that outlines how and when investment option reimbursements may be allocated back to participants and asked Department staff to provide projections on when the reimbursements policy might be implemented with the least disruption to the existing participant administrative fee structure. The attached draft policy reflects the Investment Committee's recommendations and requests related to investment options and reimbursements.

Implementation

Because the Board has previously used the investment option reimbursements across the plan to help keep all participant's annual administrative fees low, the recommendations in the attached draft policy will likely require increase(s) in the administrative fees paid by participants. The table below outlines scenarios for when this policy could be implemented and the likely increase in participant annual administrative fees.

Effective Date	Participant Fee Increase
7/1/2015	85%
7/1/2016	80%
7/1/2017	74%

To get a sense of how this will affect our members, we can look at the impact on an average participant. The analysis below was developed based on the following assumptions:

- An average WDC account balance of $70,000.
- 14% of all WDC assets are in the Fidelity ContraFund.
- 1% of all WDC assets are in the Federated US Gov't Securities fund.
- Half of WDC participants are invested in the ContraFund and Federated funds.

	Participant "A"[1]	Participant "B"[2]
Account Balance	$70,000	$70,000
Investments subject to provider reimbursements	21,000	0
Investments not subject to provider reimbursements	49,000	70,000
Annual provider reimbursement	52	0

[1] Participant "A" account is 28% ContraFund and 2% Federated.
[2] Participant "B" account is 0% ContraFund and 0% Federated.

Current Participant Fee	$48	$48
+ 85% Fee Increase (effective 7/1/2015)	41	41
= New Participant Fee	89	89

To lessen the impact on participant fees, the Board could consider a phased implementation, in which half of the investment option reimbursements would be allocated back to participants and the remaining half would be used for plan expenses until the remaining reimbursements could be allocated to participants without the need for an increase in participant fees. Under this alternative, participant fees would need to be increased as follows:

Effective Date	Participant Fee Increase
7/1/2015	41%
7/1/2016	35%
7/1/2017	28%

Although highly dependent on investment returns, it would likely be at least five years after initial implementation before sufficient assets were accumulated in the reserve to allow the remaining half of reimbursements to be allocated to participants.

Another alternative for a phased implementation would be to establish a fixed schedule for phasing in the allocation to participants, recognizing that participant annual administrative fees may need to be adjusted multiple times if reserves were not sufficient at the scheduled adjustment date.

Phase-In Period	Participant Fee Increase
4 years	61%
5 years	55%
8 years	40%

A significant disadvantage of the immediate allocation of all reimbursements to participants is that the large participant fee increase needed to offset the lost provider reimbursements will continue to build reserves, even after the target of 100% of annual expenses is reached. For example, the 85% fee increase is projected to restore the reserve balance to the target by the end of 2019. However by the end of 2021 the balance would have grown to 125% of annual expenses, and a fee reduction would likely be necessary.

Alternatively, the 61% fee increase associated with a four year phase-in of the adjustments would build reserves to the 100% target by the end of 2016, but stabilize in the 100% to 120% range for a number of years. The likelihood of a fee reduction soon after the increase is greatly reduced by a phase-in of the adjustments.

Other Considerations

Prior to implementing a new investment option reimbursements policy, the following should also occur:

1. Administrative Services Contract Amendment. Department staff have discussed reimbursements with the record keeper (Great-West Financial) and while the record keeper is able to process reimbursements to participants on a monthly basis, they would like a contract amendment or letter of instruction from the Board indicating when and how reimbursements are to be processed.

2. Communication Plan. If the reimbursements policy is adopted, it is likely to trigger increases in participant administrative fees. These increases will need to be explained by WDC staff to participants. Department staff will need to work closely with Great-West Financial staff to develop a communication plan and materials that clearly explain the changes, why they are occurring, etc.

Staff will be at the November 4, 2014, meeting, to discuss the contents of this memo.

Attachment: Proposed Investment Option Selection and Reimbursements Policy

Investment Option Selection
and Reimbursement Policy
Adopted: draft for November 2014

The Deferred Compensation Board (Board) seeks to offer low-cost share class options for the investments available in the Wisconsin Deferred Compensation Program (WDC).

When available and fiscally feasible, the Board will offer share classes (e.g., institutional) that do not provide reimbursements to the plan.

When the Board offers investment options that provide reimbursements, these reimbursements may be allocated back to the participants in the option that generated the revenue, as long as a minimum balance of 100% of anticipated annual plan expenses is maintained in the Board's administrative expense account per the Board's Administrative Expense Account Investment and Target Balance Policy.

- Mutual fund[1] reimbursements may be rebated to participants on a monthly basis.

- Fixed option[2] reimbursements may be rebated to participants when a minimum threshold amount of $5,000 from the fixed option has been reached.

  Fixed option reimbursement example:
  2013 FDIC option reimbursement received March 2014 = $472.12. For 2013, there would be no reimbursement to participants.

In the event the Board's administrative expense reserve exceeds the target balance, participants investing in options generating reimbursements may be rebated using the following calculation:

Participant fund balance x revenue share = fund reimbursement amount to participant

[1] As of September 2014, the Fidelity Contrafund and the Federated US Government Securities 2-5 year fund provided reimbursements.
[2] As of September 2014, the Stable Value Fund and the FDIC Option provided small reimbursements.