DRAFT

MINUTES

November 4, 2014

Deferred Compensation Board
State of Wisconsin

Location:
Department of Employee Trust Funds
801 West Badger Road (Mendota Room)
Madison, WI

BOARD MEMBERS PRESENT:

Ed Main, Chair
John Nelson, Vice-Chair
Gail Hanson, Secretary (via teleconference)
Michael Gracz
Art Zimmerman

PARTICIPATING EMPLOYEE TRUST FUNDS (ETF) STAFF:

Bob Conlin, Secretary
John Voelker, Deputy Secretary
Pam Henning, Assistant Deputy Secretary
Division of Retirement Services: Matt Stohr, Administrator
Deferred Compensation Program: Shelly Schueller, Director
Legal Services: David Nispel, General Counsel; Dan Hayes, Attorney
Office of the Secretary: Cheryllynn Wilkins, Board Liaison
Office of Trust Finance: Bob Willett, Chief Trust Financial Officer

OTHERS PRESENT:

Advised Assets Group (AAG):
Mike Burroughs
Bill Thornton
Galliard Capital Management, Inc.:
Mike Norman
Great-West Financial (GWF):
Emily Lockwood
Sue Oelke
Nationwide Mutual Insurance Co.:
John Piper

Mr. Main, Chair, called the meeting of the Deferred Compensation Board (Board) to order at 1:07 p.m.

Board	Mtg Date	Item #
DC	3.12.15	2

ANNOUNCEMENTS

Ms. Schueller introduced the newest Board member, Art Zimmerman. She also referred the Board to recent press releases (Ref. DC | 11.4.14 | 1A) on personnel changes within ETF and GWF's name change to Empower (Ref. DC | 11.4.14 | 1C). Ms. Schueller referred Board members to the memo (Ref. DC | 11.4.14 | 1B) for the proposed 2015 Board meeting dates.

MINUTES

> ***MOTION: Mr. Gracz moved acceptance of the minutes of the June 3, 2014, meeting as submitted by the Board Liaison. Mr. Nelson seconded the motion, which passed unanimously on a voice vote.***

DEFERRED COMPENSATION INVESTMENT COMMITTEE UPDATE

Ms. Schueller provided an update on the September 11, 2014 (Attachment A) and October 14, 2014 (Attachment B), Deferred Compensation Investment Committee ("Committee") meetings.

STABLE VALUE FUND UPDATES

<u>Changes at PIMCO</u>
Mr. Norman updated the Board on the PIMCO situation with regard to Mr. Gross and the Stable Value Fund (SVF). PIMCO is one of the sub-advisors in the WDC's SVF. Mr. Gross left PIMCO 6 weeks ago. The SVF portion at PIMCO is managed by a separate portfolio management team with more restrictive guidelines. There are no high-yield or non-investment grade type bonds. There are no issues regarding the insurance providers and Galliard's status on PIMCO is that the firm is doing fine. The SVF was rebalanced at 20% managed by PIMCO as of November 2, 2014. PIMCO currently manages approximately $150 million of WDC money within the SVF.

<u>Trustee Fee Change</u>
The SVF managed by Galliard is trusteed by Wells Fargo. Mr. Norman reminded the Board (Ref. DC | 11.4.14 | 4B) that historically, Wells Fargo has not charged a fee for collective funds across all asset classes. Over the past two years, Wells Fargo has been implementing a consistent tiered fee schedule based on complexity. This fee is an operating expense to the fund from Wells Fargo, not a Galliard fee. The expense to the WDC for the collective fund is approximately $12,000, which, when researched by Galliard, appears to be on the low end of costs when compared to similar funds offered elsewhere. Based on the existing contract between Galliard and the WDC, Ms. Schueller and Mr. Norman will continue to discuss whether the fee is permissible without a contract amendment. Ms. Schueller will report back to the Board on this issue.

CLEARINGHOUSE RULE # CR 14-055: TECHNICAL AND MINOR SUBSTANTIVE CHANGES IN EXISTING ETF ADMINISTRATIVE RULES

Mr. Hayes reviewed the changes made to the existing administrative rule as outlined in the memo (Ref. DC | 11.4.14 | 5). Changes include: revising obsolete language to bring the rule in compliance with ETF's current administrative practices and conform to statutory changes and some minor substantive changes with respect to the Wisconsin Deferred Compensation Program.

> ***MOTION: Mr. Gracz moved to accept Clearinghouse Rule # CR 14-055 as presented. Mr. Nelson seconded the motion, which passed unanimously on a voice vote.***

PLAN AND TRUST DOCUMENT REVISIONS

Mr. Hayes discussed the proposed Plan and Trust document changes to the Board (Ref. DC | 11.4.14 | 6). The first change applies only to some local employees (not to state employees) and clarifies that permitting unused leave to be deferred to the WDC is at the discretion of the employer. Accumulated sick pay is not to be confused with accumulated unused sick leave, which applies to state employees. Under Wis. Stats. § 40.05 (b), accumulated unused sick leave can only be used to pay for health insurance premiums after retirement or death of a member.

The second change is regarding the in-plan Roth Conversions. Upon Board approval, the WDC will start to notify participants regarding these changes and a communication plan will be put together for participants who would be interested in taking advantage of the in-plan Roth Conversion.

> ***MOTION: Mr. Gracz moved to approve the proposed changes to the Plan and Trust document as presented, which will clarify***
> ***1) that an employer may specify whether to permit an employee to defer accumulated sick pay, accumulated vacation pay or back pay to the WDC, state that accumulated unused sick leave may not be deferred; and***
> ***2) that in-plan Roth Conversions are permitted.***
>
> ***Mr. Nelson seconded the motion, which passed unanimously on a voice vote.***

INVESTMENT PERFORMANCE REVIEW

Mr. Thornton referred to the Investment Fund Performance Review report for the period ending September 30, 2014 (Ref. DC | 11.4.14 | 7B). He reported that all funds have met or exceeded the benchmarks with the exception of the Calvert Equity Fund.

Mr. Thornton also noted the extreme drop in the three-year quartile rankings of the Federated U.S. Government Fund. This fund has not been doing anything different regarding money management and investments. However, with the rotating off of a really good third quarter in 2012 and only about 60 funds in this fund's peer group category, a small performance variance can create a big change. The Federated swing is less than 1% in its peer group and Mr. Thornton feels the Board does not need to take action at this time.

The WDC has a total of 55,262 participants with an accumulated total of 242,485 accounts. The one year weighted return for the WDC as of September 30, 2014 was 10.64%, with much of the return attributed to the significant level of funds invested in the Fidelity Contrafund, which returned 17.42%.

INVESTMENT POLICY STATEMENT UPDATE

Ms. Schueller referred the Board to the memo and draft revisions (Ref. DC **|** 11.4.14 **|** 8). The Investment Policy Statement is an important document because it reflects the Board's philosophy regarding investment options, why various options are included and when, why and how options might be removed. The Board reviewed the additions and changes within the policy and the reasoning as to why the changes were recommended by the Investment Committee and staff. As a result of suggestions by the Investment Committee, there are proposed changes in the IPS and particularly in the monitoring criteria.

> ***MOTION: Mr. Gracz moved to approve the proposed revisions to the Investment Policy Statement as presented. Mr. Nelson seconded the motion, which passed unanimously on a voice vote.***

COMPATIBILITY OF TRUSTEE RESPONSIBILITIES UNDER WIS. STAT. § 40.01 (3)

Mr. Hayes responded to the Board's request regarding fiduciary responsibilities and the compatibility of trustee responsibility under Wis. Stat. § 40.01 (3) referencing Board memo (Ref. DC **|** 11.4.14 **|** 9). This statute outlines the Board's basic responsibilities. The statute includes language explaining that the Board does not have a conflict of interest in carrying out its responsibilities and duties related to the WDC, including making decisions on investments and reimbursements. However the statute does prohibit Board members from taking action on their own specific benefit (like an appeal).

POLICY PROPOSALS

<u>Target Administrative Expense Account Balance Policy Revisions</u>

Ms. Schueller referred the Board to the memo (Ref. DC **|** 11.4.14 **|** 10A). The Board has been discussing its fiduciary responsibilities regarding best practice for participants as related to reimbursements from a few WDC investment options. The Board is searching for the best solution for all WDC participants, evaluating the overall administrative fees participants are paying verses the reimbursements.

From Investment Committee discussions, changes have been recommended for the Administrative Expense Account Investment and Target Balance Policy to set a target balance in the account to cover 100% of estimated annual plan expenses. The Investment Committee recommends the target balance at this higher level so the Board can maintain services, achieve goals and fund new initiatives and services. This policy will help to avoid revenue shortfalls, unplanned increases in participant administrative fees and provide the ability to respond to unexpected opportunities or unanticipated economic downturns.

> ***MOTION: Mr. Nelson moved to approve the update to the administrative expense account investment and target balance policy to state that the policy is to maintain a target balance of 100% of annual plan expenses. Mr. Gracz seconded the motion, which passed unanimously on a voice vote.***

<u>Investment Option Selection and Allocation of Reimbursements – New</u>

Ms. Schueller and Mr. Willett discussed share class reimbursements, investment selection and presented a draft policy for Board consideration (Ref. DC | 11.4.14 | 10B). The draft policy seeks to address the reallocation of reimbursement funds to the participants that generated the reimbursement as long as the minimum balance of 100% of annual plan expenses is maintained. The Board agreed that it would prefer to keep the 100% annual plan expense policy separate from the policy regarding distribution of reimbursement funds to the participants. Additionally, participant administrative fees are a separate subject, not to be combined with plan expenses or reimbursement policies.

GWF can process participant fund reimbursements on a monthly basis. If the Board decides to change its reimbursements policy and return reimbursements directly to participants, the Board must provide GWF a letter of instruction or a contract amendment before GWF could execute this policy.

Reallocating the reimbursement revenues will likely cause the WDC's administrative balance to drop rapidly. Mr. Willett's analysis indicates that distributing reimbursements only to the participants that generated the reimbursement means the WDC may lose more than a million dollars of revenue that is currently devoted to administrative costs. The plan is currently at its 50% funded target, but well under the new 100% target. Mr. Willett estimated that implementing the reimbursement policy change immediately would require participant fees to increase by up to 80%.

Historically, participant administrative fees are reviewed annually in the spring for the following year. Changes to the fee structure were last made in 2008.

The Board would like to disburse all generated reimbursement funds to the participants that generated the reimbursement. Staff and GWF will need to create a communication plan explaining the change in the fee schedule and the reimbursement for the participants of the specific funds. The draft Investment Option Selection and Reimbursement Policy will be rewritten based on the Board's discussion and submitted for motion at the March 2015 Board meeting, with a goal implementation date of July 1, 2015.

PLAN ENHANCEMENT PROGRAM (PEP)

Ms. Oelke and Ms. Lockwood reviewed and discussed the 2014 PEP scorecard (Ref. DC | 11.4.14 | 11A). The participation goals of 1.5% increase of employees and adding eight new employers was exceeded with 2.8% growth of in-force accounts and 12 new employers added. In-force accounts are the net of new employees who enroll in the WDC and those who withdraw from the WDC. Ms. Oelke has been working with Brown County, one of the largest counties in the state, for many years and they finally adopted the plan. WDC is starting to see more of the larger counties coming forward to enroll in the WDC because of its fiduciary oversight, the competitive fees, the service and overall focus on communication and education. Even with the change in fee structure, the employers will continue to seek enrollment in the WDC because the low internal expense ratios of the investment options, the Board's strong fiduciary oversight and the focus on education.

With regard to education and learning, GWF is providing a large number of group and individual meetings, in addition to webinars. Participant attendance at the pilot webinars has been extremely high. A recent pre-retirement webinar had more than 700 participants attend the webinar live and within 24 hours, 80 people requested to be on our email distribution list.

Ms. Oelke and Ms. Lockwood reviewed the 2015 PEP proposal and the Strategic Plan. GWF will continue to focus on four dimensions:

- Participation (Employees and Employers)
- Asset Allocation
- Education and Learning
- Retention/Retiree Outreach.

GWF is freshening its marketing approach by using a "What's your excuse?" campaign. This campaign has already been piloted with success in Texas. Regarding employer goals: It may appear that the goal numbers are low for new employer participation, but with the addition of larger employers (with greater potential for more employees), these political subdivisions require more time than smaller organizations.

In addition to the standard outreach plans outlined in the PEP, in 2015 GWF will partner with ETF's Affirmative Action Committee (AAC) in a new effort designed to present minorities and women with information about the importance of understanding personal finance and the benefits of the WDC.

A suggestion was made for a mid-year score card revision if the administrative fee schedule changes for participants as a result of the previously discussed share class reimbursement reallocation.

> ***MOTION: Mr. Nelson moved to approve the proposed 2015 Plan Enhancement Program as presented, with the addition of "If the***

> ***reimbursements policy is finalized and implemented in 2015, a goal reflecting a communications policy will be added to the 2015 scorecard." Mr. Gracz seconded the motion, which passed unanimously on a voice vote.***

OPERATIONAL UPDATES

Ms. Schueller referred Board members to the materials under the "Operational Updates" section in the meeting materials for routine reports and additional information and news from the WDC's investment providers. (Ref. DC **|** 11.4.14| 12).

FINANCIAL STATEMENTS AUDITOR PROCUREMENT

Mr. Main indicated the Board would convene in closed session to discuss the procurement of a financial statements auditor.

> ***MOTION: Mr. Nelson moved to convene in closed session, pursuant to the exemptions contained in Wis. Stat. § 19.85 (1) (e) to deliberate or negotiate the investing of public funds. Mr. Gracz seconded the motion, which passed on the following roll call vote:***
>
> ***Members Voting Aye: Gracz, Hanson, Main, Nelson, Zimmerman***
>
> ***Members Absent: None***

The Board convened in closed session at 3:00 p.m. and reconvened in open session at 3:16 p.m.

ANNOUNCEMENT OF ACTION TAKEN ON BUSINESS DELIBERATED DURING CLOSED SESSION

Mr. Main announced the Board took the following action during closed session:

The Board authorized the Board Chair to negotiate and approve a contract with a certified public auditing firm for financial statements audits beginning with calendar year 2016.

ADJOURNMENT

> ***MOTION: Mr. Nelson moved to adjourn. Mr. Gracz seconded the motion, which passed unanimously on a voice vote.***

The Board adjourned at 3:19 p.m.

Date Approved: ___________________________

Signed: __________________________________
Gail Hanson, Secretary
Deferred Compensation Board

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CORRESPONDENCE MEMORANDUM
Attachment A

DATE: November 4, 2014

TO: Deferred Compensation Board Members

FROM: Shelly Schueller

SUBJECT: September 11, 2014 Investment Committee Meeting Notes

1. The Committee met and discussed the investment performance results as of June 30, 2014, with Mr. Thornton. All but one fund looks good, when compared to their respective three- and five-year benchmarks. The Calvert Equity Fund continues to struggle, falling in the ranking to the third quartile (16%) in the second quarter of 2014. Mr. Thornton noted that Calvert is the WDC's socially responsible fund and it has been struggling over the last year due to Calvert's socially responsible limitations vis-a-vis the benchmark indices, particularly due to Calvert's weighting in consumer cyclical and energy stocks. The Committee directed Mr. Thornton to review the existing options (index and active) in the socially responsible arena prior to the November Board meeting, when Calvert's performance will again be reviewed.

   The Committee discussed the Investment Policy Statement (IPS) with Mr. Thornton, who noted that with the current language in the IPS, there are a few funds that do not meet the minimum monitoring criteria of a minimum of 3% of assets **or** 3% of participants in the fund after the fund has been part of the WDC for five years. The Committee discussed removing these criteria, or alternatively, removing some funds for non-performance in the monitoring area. The Committee recommended removing the 3% criteria and directed staff to prepare a memo for the next Board meeting relaying this recommendation.

   In reviewing the June 30, 2014 performance results, the funds not meeting one or the other of the 3% monitoring standards are:

Investment Option	Below 3% of Participants	Below 3% of WDC assets
BlackRock Russell 2000	1.97%	1.44%
Calvert Equity	1.83%	1.15%
FDIC Option	1.32%	2.38%

Federated US Gov't 2-5	2.25%	0.86%
Schwab PCRA	0.55%	1.72%
Vanguard Target Ret. Date	All	All but 2025 fund

The Committee discussed the current offerings, reminding staff the Board has chosen to add an actively managed fund and an index fund in certain investment arenas. Thus, while the BlackRock Russell 2000 does not meet the current criteria, it is unlikely that the BlackRock Russell 2000 will be removed.

Staff noted the Calvert Equity fund has been considered a specialty fund and consequently not held to the 3% requirement. In addition, the Vanguard target retirement date funds are considered one type of fund offering and often grouped together as the WDC's "lifecycle" or target date retirement option. The Schwab PCRA is the brokerage window and could also be considered a specialty offering. The Federated and FDIC options do not meet current criteria, although both are close.

2. The Committee reviewed the Board's fiduciary responsibilities as they relate to allocation of the reimbursements the plan receives from certain investment options. The Committee agreed that when fiscally prudent and when a lower-cost (e.g., institutional) share class is available, changing share classes to offer share classes that do not provide reimbursement is good policy.

   The Committee discussed rebates to participants in the funds providing smaller reimbursements (e.g., FDIC and Stable Value). Staff suggested eliminating these rebates. Based upon current usage of these funds and the small annual reimbursement, the rebate equates to approximately $0.17 per participant. The Committee asked staff to continue to explore options and pros and cons related to rebating these reimbursements to the participants.

   The Committee asked staff to do the following:
   - Prepare an update to the Administrative Expense Account Investment and Target Balance Policy that affirms the Board's position that maintaining a target balance in the administrative expense account to satisfy the plan's anticipated expenses is desirable.
   - Develop a policy that outlines how fund reimbursements will be allocated back to the participants in the fund that generated the revenue, as long as a minimum balance of 100% of annual plan expenses is maintained in the Board's administrative account. Note: This proposal would need further analysis to develop projections on when this might be accomplished with the least disruption to the existing participant fee structure. The Committee believes a monthly rebate would be preferable, which is in line with the plan administrator's capability and preferences.

- Provide the Board with simulations demonstrating the potential impact of the reimbursement change on participants' administrative fees based upon when participants might begin receiving the reimbursements.
- Provide information on a typical reimbursement, based upon an average WDC account balance of $50,000.

3. The Committee discussed potential revisions to the Investment Performance Statement (ISP). Per a comment from the Board, the Department reviewed the ISP, which was formally created in 1998 and last updated in 2005. Revisions proposed for consideration are intended to more accurately reflect the current investment spectrum, selection and monitoring practices. The Committee pointed out a few typos that need correcting but agreed with staff's changes as presented. This recommendation will be presented at the November 2014 Board meeting.

4. It was noted that ETF's legal counsel are reviewing State Statutes and Administrative Code for potential conflict of interest problems regarding the reimbursement allocation decision. ETF expects to have a written legal opinion available for review at the November Board meeting.

STATE OF WISCONSIN
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CORRESPONDENCE MEMORANDUM ATTACHMENT B

DATE: November 4, 2014

TO: Deferred Compensation Board Members

FROM: Shelly Schueller

SUBJECT: October 17, 2014 Investment Committee Meeting Notes

The Committee met via teleconference with Galliard to discuss the recent changes at PIMCO and the effects on the WDC's Stable Value Fund. One of PIMCO's founders, Bill Gross, left the firm to work for a competitor. As of September 30, 2014, the Stable Value Fund (SVF) has a balance of $612,000,000, of which approximately 24% is in a bank collective fund managed by subcontractor PIMCO. However, none of the WDC's SVF had been managed by Mr. Gross. Mr. Gross managed other funds at PIMCO.

Mike Norman and Jenny Hopper from Galliard noted that the SVF is part of a Galliard-exclusive fund/mandate at PIMCO and thus is not currently subject to cash out flow concerns. Galliard does not have any immediate concerns regarding the portfolio that PIMCO is managing for Galliard and its clients. The PIMCO portion of the SVF is wrapped by TransAmerica and Voya, both of which are also comfortable with the current PIMCO strategy.

Ms. Hopper stated that Galliard has been watching PIMCO closely since earlier this year, after Mohamed El-Erian, widely viewed as the successor to Bill Gross, resigned in March 2014. Galliard has a regularly-scheduled due diligence trip to visit PIMCO later this month. Galliard will provide an update at the Board's November 2014 meeting.