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# CORRESPONDENCE MEMORANDUM

**DATE:** February 16, 2015

**TO:** Deferred Compensation Board

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

**SUBJECT:** Allocation of Investment Option Reimbursements: Proposed Policy, Possible Impacts and Potential Implementation Timeline

**Staff recommends the Board approve the Investment Option Selection and Reimbursements policy as presented, with the implementation date delayed until the Board's administrative expense account reaches 100% of anticipated annual expenses.**

Throughout 2014, the Board reviewed share classes and discussed allocation of investment option reimbursements. At the November 2014 Board meeting, staff presented a draft Investment Option Selection and Reimbursements Policy for Board consideration. (Ref. DC | 11.4.14 | 10B). During the discussion in November, the Board indicated a preference for certain language and detail in the policy and directed staff to revise the policy and provide the Board with an updated draft to review.

## Proposed Policy

The attached draft Investment Option Selection and Reimbursements Policy has been rewritten and is presented to the Board for discussion and approval. If approved, this policy will be updated in the *Deferred Compensation Board Governance Manual*.

## Possible Effect on Participant Administrative Fees

Projections show that given current trends, the Board's administrative account will reach its target balance of 100% of annual expenses in early 2019. This would allow implementation of the Allocation of Investment Option Reimbursements Policy by mid-2019. We project, at that time, a 61% increase in participant fees would be required to offset the allocation of provider reimbursements. The effect on an average participant with a $70,000 account balance would be as follows:

Reviewed and approved by Matt Stohr, Administrator
Division of Retirement Services
Matt Stohr Electronically Signed 2/20/15

| Board | Mtg Date | Item # |
|---|---|---|
| DC | 3.12.15 | 8 |

| Scenario One: Policy Implementation When Board Account Reaches 100% of Target Balance | Participant "A"[1] | Participant "B"[2] |
|---|---|---|
| Investments subject to provider reimbursements | $21,000 | $ 0 |
| Investments not subject to provider reimbursements | 49,000 | 70,000 |
| Total Account Balance | 70,000 | 70,000 |
| Annual Provider Reimbursement Received | 52 | 0 |
| **Current Participant Fee** | **$48** | **$48** |
| 61% Fee Increase | 29 | 29 |
| Provider Reimbursement Allocation | (52) | 0 |
| **Net New Participant Fee** | **$25** | **$77** |

Alternatively, the Allocation of Investment Option Reimbursements Policy and the associated participant fee increase could be implemented as soon as January 1, 2016. Since we would be building reserves to the 100% target at the same time we are replacing the reimbursements allocations, an 82% increase in participant fees would be required. Even with this increase, we would not expect to reach the target reserve balance before 2020. The effect of this larger fee increase on an average participant would be as follows:

| Scenario Two: Policy Implementation on January 1, 2016 | Participant "A"[1] | Participant "B"[2] |
|---|---|---|
| Investments subject to provider reimbursements | $21,000 | $ 0 |
| Investments not subject to provider reimbursements | 49,000 | 70,000 |
| Total Account Balance | 70,000 | 70,000 |
| Annual Provider Reimbursement | 52 | 0 |
| **Current Participant Fee** | **$48** | **$48** |
| 82% Fee Increase | 39 | 39 |
| Provider Reimbursement Allocation | (52) | 0 |
| **Net New Participant Fee** | **$35** | **$87** |

These increases are illustrative only. When the Board reaches a decision on an implementation timeline and strategy, the Department will provide the Board with recommendations on how to incorporate the increase into the fee tiers.

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

## Implementation Timeline

Staff recommends the Board consider a future implementation date for this policy for two reasons:

1) To ensure the Board's account has sufficient funding to pay for expected program expenses and meet the target balance. As approved by the Board in November 2014, the target goal for the Board's administrative expense account is 100% of annual plan expenses; and

2) To enable staff time to prepare and implement a communications strategy to explain the new policy and changes to participants, which are likely to cause an immediate and large increase in participant administrative fees. Participants will not be expecting this increase and may be confused, frustrated and possibly upset. A well-planned and executed communications strategy is a necessary part of any successful implementation plan.

   After discussions with the WDC's administrator, staff recommend the following communications strategy and timeline:

   a. *Phase 1: Initial Communications*
      - Target start date: to be determined by Board
      - Begin by providing participants with a basic explanation of how WDC fees are assessed, recovered and what they are used for. This can be done through an article in the WDC newsletter and on the WDC website. Local WDC staff should also include this information in their on-site presentations.
   b. *Phase 2: Explain Restructuring*
      - Target: 3 months after Phase 1 begins
      - Explain the new reallocation of reimbursements and how participant administrative fees will be calculated and deducted. The focus will be communicated through the WDC website, newsletter, and an informational hand-out. The WDC's administrator may also develop a short presentation that can be used at on-site presentations.
   c. *Phase 3: Implement Reimbursement Reallocation*
      - Target: 6 months after Phase 1 begins
      - Implement the mutual fund reimbursements to the respective participant accounts. Dedicate the majority of the WDC newsletter to explaining the fee reimbursement and where participants can see the amount on their statement.
   d. *Phase 4: Implement Revised Participant Administrative Fees*
      - Target: 9 months after Phase 1 begins
      - New administrative fee structure explained online and again in the WDC newsletter and perhaps in a direct mailing to all participants.

Staff will be at the Board meeting to discuss the contents of this memo with the Board.

Attachment: Draft Allocation of Investment Option Reimbursements Policy

# Investment Option Selection
# and Reimbursements Policy

***Adopted:*** *draft for March 12, 2015 Board meeting*
*Draft as of February 3, 2015*

**Investment Option Selection**

The Deferred Compensation Board (Board) seeks to offer participants quality, low-cost investment options through the Wisconsin Deferred Compensation Program (WDC). When available and fiscally feasible, the Board will offer these investment options in share classes (e.g., institutional) that do not provide reimbursements to the plan.

**Reimbursements Policy**

When an investment option provides reimbursements, these reimbursements may be allocated back to the participants in the option that generated the revenue when the reimbursement on individual WDC accounts exceeds one cent during a month.

- Mutual fund[1] reimbursements may be rebated to participants on a monthly basis. Participants investing in options generating reimbursements may be rebated using the following calculation:

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

- After the annual reimbursement has been received from any fixed options[2] offering reimbursements, these reimbursement may be rebated to participants when a minimum rebate threshold amount of one cent per participant has been reached.

  Fixed option reimbursement example:
  Number of participants using the FDIC option as of December 31, 2013: 3,373
  2013 FDIC option reimbursement received March 2014 = $472.12.
  $472.12/3,373 = 0.139

  For 2013, there would be a reimbursement of $0.13 to FDIC option account holders.

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[1] As of January 2015, the Fidelity Contrafund and the Federated US Government Securities 2-5 year fund provided reimbursements to the WDC on a quarterly basis.
[2] As of January 2015, the Stable Value Fund and the FDIC Option provided small reimbursements to the WDC on an annual basis.