

Products and Asset Allocation

Wednesday, September 21, 2005



Products and Asset Allocation

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The Investment Policy Statement

- A tool to help plan fiduciaries make sound, prudent investment decisions
- Provides a roadmap for equipping participants with competitive and appropriate investment options, information, and education
- Benefits include:
 - Saves time, money, and frustration by putting decision-makers on the same page
 - Leads to better investment decisions, which leads to better performance, which leads to happier employees
 - Helps demonstrate procedural prudence to regulators, auditors, and any other interested parties



Objectives & Policy Decisions

A good policy statement links fiduciary decisions back to plan investment objectives. For example:

**Investment
Objective**



**Policy
Decisions**

Provide employees access to a competitive and appropriate set of investment options.

- How many options will be offered?
- What asset classes, categories, or styles?
- What criteria (benchmarks, etc) will be used to select and monitor each option?

Style and Structure

Investment Policy Statement

Plan Governance

Needs and Circumstances of Employees

Plan Investment Objectives

Education Program Design

Investment Categories

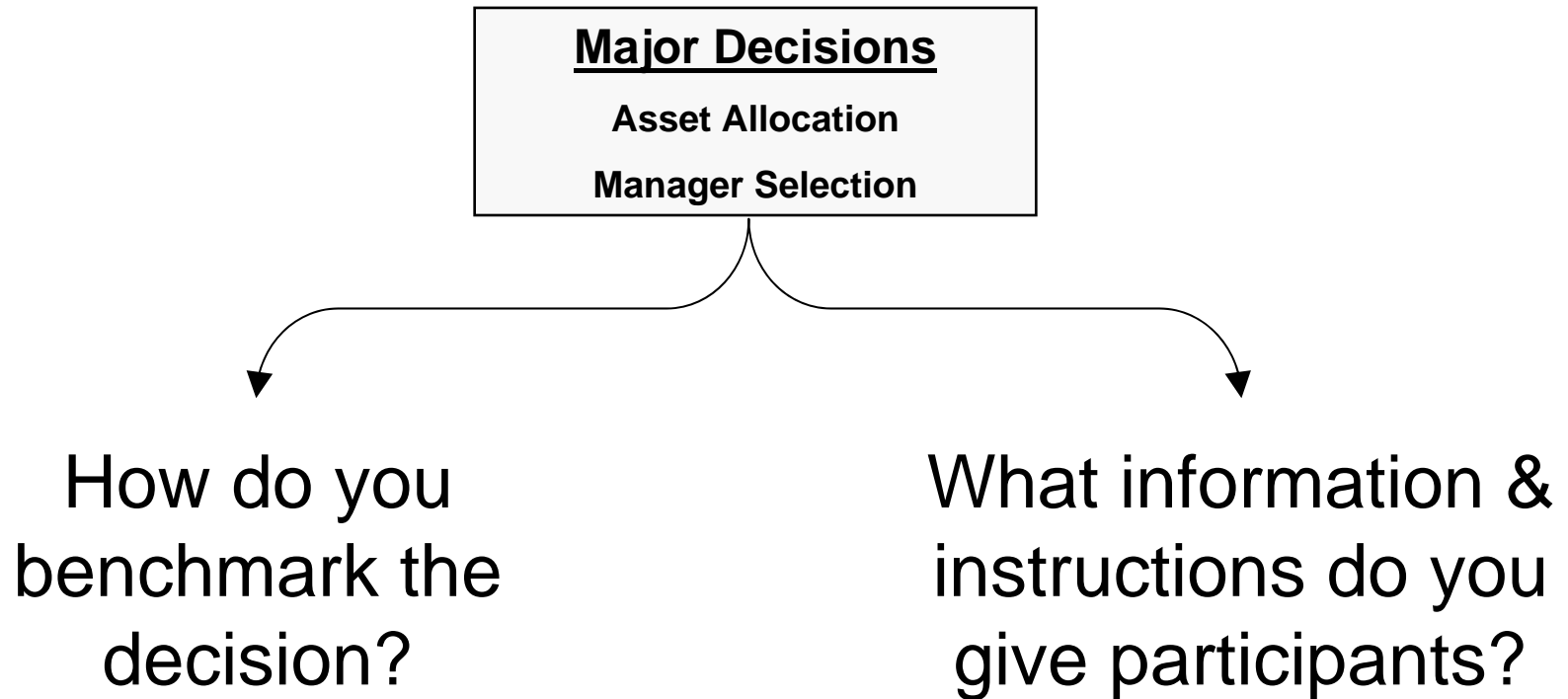
Selection and Monitoring Criteria

Appendices: Current options, benchmarks, committee members.

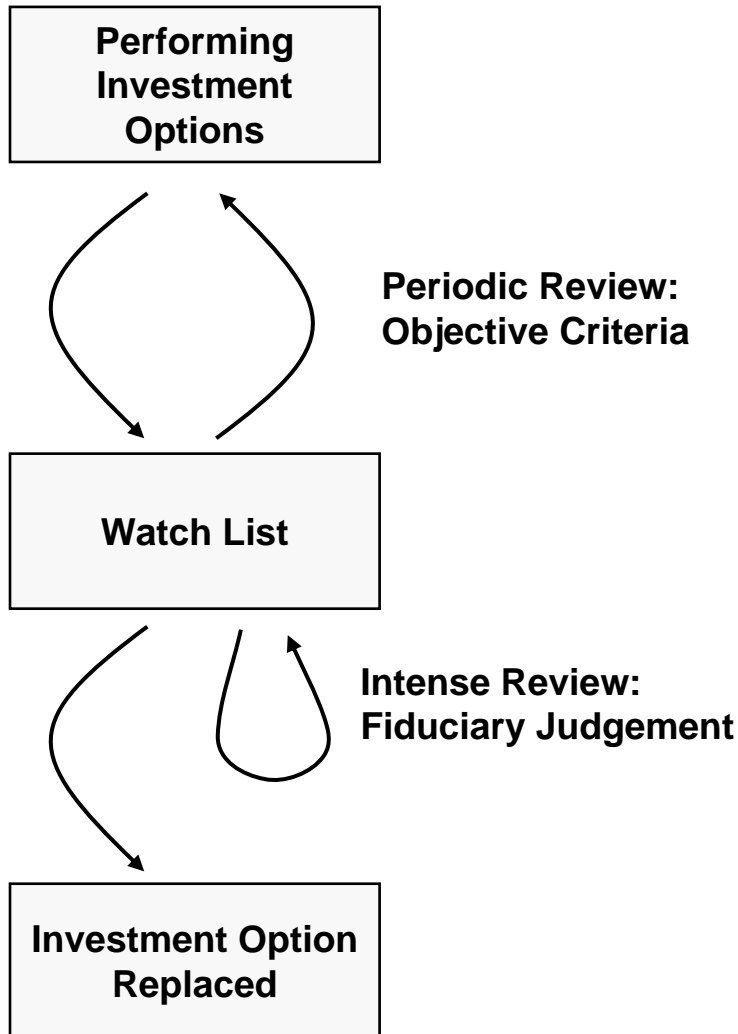
- **Writing styles vary widely – you should use a style comfortable to you and your organization.**
- **General tips:**
 - Identify decision-makers
 - Cover both education/advice and choice strategies
 - Include objective and subjective criteria
 - Avoid mentioning specific funds or vendors (use an appendix)
 - Avoid duplicating the law or other plan documents



Making Decisions vs. Delegation



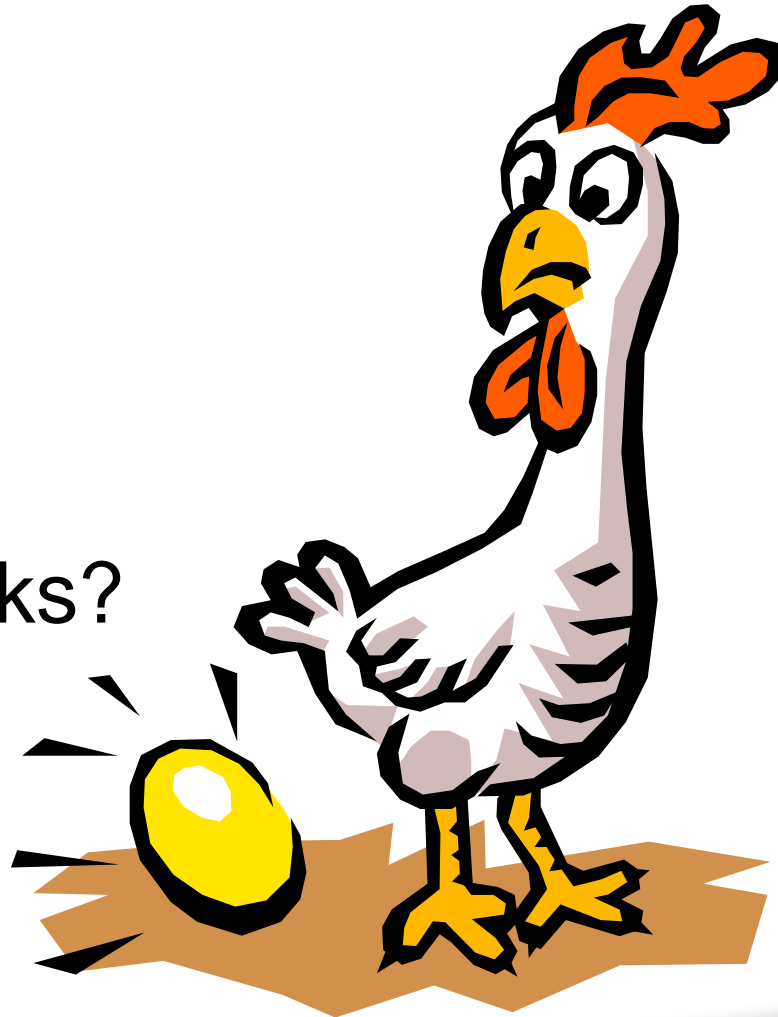
Policy Implementation



- Once investments have been selected, the Plan Sponsor must monitor them to make sure they remain prudent choices.
- The decision to replace an underperforming fund must balance the risk of underperformance versus disruption and the risk of switching to something worse.
- **A multi-phase review process usually works best:**
 - Create a “watch list” by using objective, quantitative criteria
 - Reporting against watch list criteria should be frequent and automated, with in-depth analysis performed less frequently
 - Investment Committee reviews the watch list funds frequently and carefully
 - The decision to remove a fund from the Plan is usually more subjective

Which Comes First?

Benchmarks?

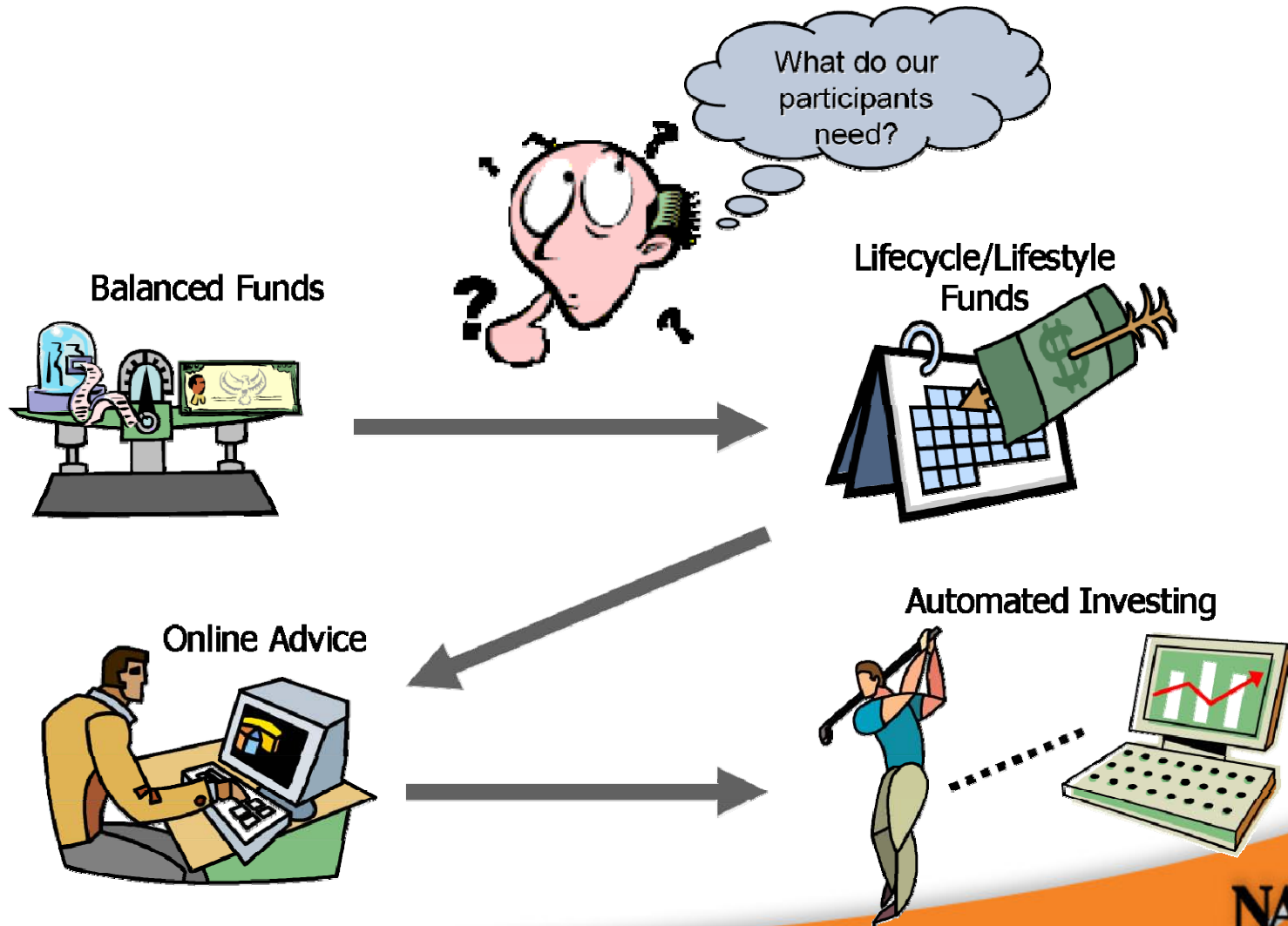


Investment
Funds?

Benchmarking Basics

- Passive Indices
 - Benchmarks return, risk, portfolio strategy
 - Requires skill to select the right index
 - Examples: S&P, Russell, Lehman, MSCI
- Peer Groups
 - Benchmarks return and fees only
 - Easy to select based on fund's membership
 - Suffers from survivor bias, "drift"
 - Examples: Lipper, Morningstar

Asset Allocation / Advice Landscape



Stable Value

- Stable Value funds are one of several options plans have to choose from in the conservative end of the product continuum.
- Stable Value funds are distinct from market value funds (e.g., mutual funds or market valued separate accounts) in their accounting characteristics.
- Book Value treatment of benefit payments is the reason for the use of the funds



Approaches to Management

- Stable Value Options may be Managed
 - Internally
 - Externally
 - Insurance Company
 - Investment Advisor
 - Combination (Internal/External)
- A variety of performance benchmarks are used in these funds including Hueler indices, constant maturity treasuries and money fund indices

Stable Value Products

- Whether internally or externally managed, the option enjoys book value treatment due to the instruments held within the fund.
- The book value products used most often within stable value portfolios are:
 - Traditional/Balance Sheet GICs
 - Separate Account GICs
 - Synthetic GICs
 - Collective Funds

Traditional GICs

- Traditional/Balance Sheet GICs.
 - Issuer: Insurance Company (typically)
 - Return: Fixed Rate, asset performance or index based
 - Crediting Rate: Typically fixed but may reset quarterly
 - Maturity: Fixed Maturity or Open maturity (no specific end date)
 - Termination: Varies
 - Underlying Assets (composition): “Slice” of general accounts held by insurance company.
 - Underlying Assets (ownership): Assets are owned by insurance company

Separate Account GICs

- Separate Account GICs
 - Issuer: Insurance Company
 - Return: Return of underlying assets
 - Crediting Rate: Typically resets quarterly
 - Maturity: Fixed or Open maturity
 - Termination: Various provisions
 - Underlying Assets (composition): Typically fixed income instruments usually managed by insurance company or affiliate
 - Underlying Assets (ownership): Assets are owned by insurance company, but contractholder has “claim” on assets specifically backing contract

Synthetic GICs

- Synthetic GICs
 - Book value (wrap) provider: Insurance company or bank
 - Return: Return of underlying assets
 - Crediting Rate: Typically resets quarterly
 - Maturity: Open (perpetual) maturity
 - Termination: Formula as provided in contract
 - Underlying Assets (Composition): Fixed income instruments; may be individually purchased securities or portfolios managed by investment management firms (typically unrelated to book value/wrap provider)
 - Underlying Asset (Ownership): Plan owns assets

Collective Funds

- Collective Funds
 - Commingled fund offered by bank or other financial institution
 - Return: Return of portfolio of assets (made up of various instruments)
 - Crediting Rate: Daily NAV or constant \$ NAV
 - Termination: 12 month notice for plan to terminate
 - Underlying Assets (Composition): Various stable value and fixed income instruments
 - Some commingled funds are available on the NSCC platform for ease of trading

Considerations

- Although the use of any of these Book Value instruments (within an eligible plan) make the desired accounting possible, participants want options with a combination of the following characteristics:
 - Safety: Strong credit quality; some degree of rate responsiveness; crediting rate with little volatility
 - Liquidity: Benefit payments will be available at Book Value
 - Returns: Competitive and predictable returns

Portfolio Composition

- The manager of the Stable Value option seeks the optimal combination of instruments in the portfolio in order to maximize these attributes while taking into consideration the profile of the participants.
- The aggregate participant profile (or liability of the option) will lead to formulating an investment policy and resulting asset strategies that fulfill the policy set at the plan and fund levels.
- The strategy will figure prominently in determining:
 - the book value instruments to use,
 - the allocations among those instruments and the
 - risk profile (e.g., maturity, credit quality, credit exposure, liquidity) of the instruments as the portfolio is constructed and ongoing cashflows are invested.



Plan Design – Tiered Approach

Passive Core Investment Funds

Lehman
Brothers
Aggregate
Index Fund

S&P 500
Index Fund

S&P 400
Index Fund

Russell
2000 Index
Fund

Lifestyle / Aged Based Funds

Lifestyle
Income
Fund

Lifestyle
2010
Fund

Lifestyle
2020
Fund

Lifestyle
2030
Fund

Lifestyle
2040
Fund

Self-Managed Accounts

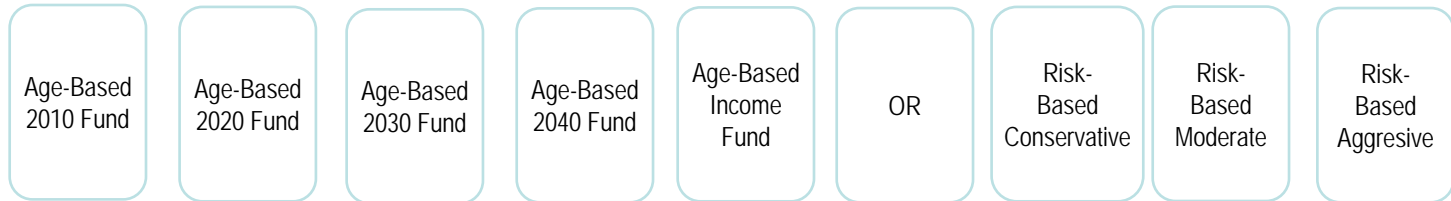
Self-Managed
Mutual Funds

Self-Managed
Brokerage



Plan Design – Tiered Approach

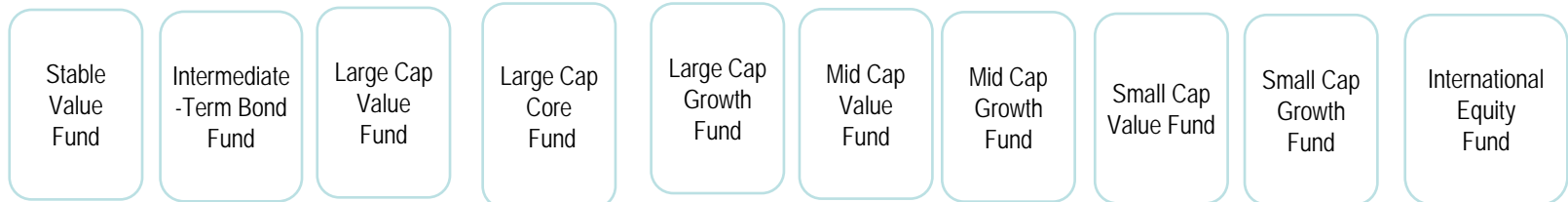
Life Strategy Asset Allocation Funds



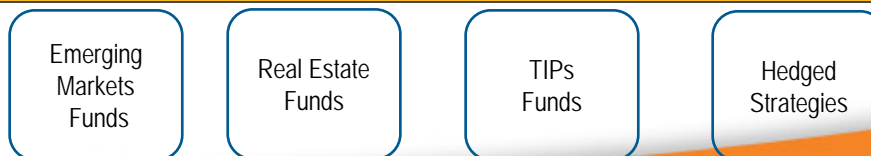
Passive Core Investment Funds



Active Core Investment Funds



Extended Choice



CitiStreet Fund Selection and Monitoring Process

15,000 MUTUAL FUNDS AND COMMINGLED FUNDS

TOOLS AND METHODS

- Due Diligence Meetings
- Survey Information from Fund Companies
- Outside Sources
 - Morningstar
 - Lipper
 - Bloomberg
 - News Sources

QUANTITATIVE ANALYSIS

- Information Ratio
- Sharpe Ratio
- Alpha
- Annualized Returns
- Standard Deviation
- 1 Year Rankings
- 3 Year Rankings
- 5 Year Rankings

QUALITATIVE ANALYSIS

- Investment Philosophy
- Investment Process
- Style Consistency
- Asset Allocation
- Ownership Structure and Stability
- Expense Ratio
- Manager Tenure
- Investment Professional Turnover

BEST OF CLASS LIST

WATCH LIST



Fees

- Are Fees / Revenues disclosed?
- Fees to consider include Market Value adjustments, Deferred Sales Charges
- Redemption Fees - are redemption fees understood & communicated? (especially which transactions are affected)
- Do participants understand fees? Is there anything related to fees on a participant statement?

Thanks for Your Time!

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