

# **MONTEREY COUNTY DEFERRED COMPENSATION PLAN INVESTMENT POLICY STATEMENT**

## **PURPOSE:**

This Investment Policy Statement (Policy Statement) sets forth the goals and objectives of the investment options to be included in the Monterey County Deferred Compensation Plan (the "Plan"). The purpose of this Investment Policy Statement is to guide the Monterey County Deferred Compensation Administrative Committee ("Committee") in effectively supervising, monitoring and managing the investments of the Plan. This policy statement is designed to allow for sufficient flexibility in the management oversight process while setting forth reasonable parameters to ensure prudence and care in the execution of the investment option, a procedure for the on-going evaluation of the investment option in the Plan, and provides guidelines for the possible replacement of any investment option. This Policy does not apply to the "Self-Directed Brokerage" features should such feature be adopted as a part of the Monterey County Deferred Compensation Plan.

## **BACKGROUND**

The Plan was established on February 14, 1984 and is administered by Monterey County, and is intended to qualify as an IRC Section 457 plan. The Plan is intended to provide eligible employees with a means to save monies on a tax-advantaged basis in order to assist the employee in reaching his/her financial goals. The Plan allows each eligible employee to self-direct how his or her contributions to the Plan are invested among a diverse menu of investment options selected by the Committee.

The Committee oversees the Plan on behalf of the eligible participants. Part of the duties of the Committee is to determine which investment options are parts of the Plan, and to monitor the investment options compliance with the Investment Policy.

The Committee, Trustees and the Investment Manager do not provide investment advice to participants or assist participants in selecting the funds in which to invest. Fiduciaries are not responsible for losses in individual accounts resulting from the participant's investment selection, or from any action taken in accordance with the participant's investment direction.

## **INVESTMENT OPTION SELECTION**

The Committee recognizes there is investment risk inherent in all investment options. Furthermore, individual participants have their own level of risk tolerance in anticipation of achieving potentially higher returns. The Committee provides participants with a broad array of investment choices, so participants have multiple alternatives providing different levels of risk and return. With the exception of the Fixed Income/Stable Value option, the Committee has approved use of Mutual funds and/or variable annuities. To this end, the Committee selects funds based on the following criteria:

**1)** Funds will represent the major asset classes. For purposes of this policy statement, the following major asset classes will be used, at a minimum, as defined by Morningstar (an independent fund evaluation company).

- a. International
- b. Small-Cap equity
- c. Mid-Cap equity
- d. Large-Cap equity
- e. Index Fund
- f. Balanced/Asset allocation funds
- g. Fixed income/Stable Value

**2)** From among funds in the domestic equity asset classes as identified above in 1b, c, and d, the Committee will attempt to choose funds with contrasting stock selection styles. The Committee will attempt to choose funds that both tend to purchase “value” stocks (stocks that are purchased because the fund manager believes the stock is under valued) as well as funds that tend to purchase “growth” stocks (stocks of companies who have shown accelerated earnings).

**3)** The Committee will select funds based upon administrative, pricing, and other mutually agreeable criteria in conjunction with the Plan’s record keeper.

**4)** The expense ratio of the funds, both before and after revenue sharing, must be competitive with other funds with similar objectives.

**5)** Whenever practical, the Committee will choose funds that are offered from companies that have a reputation as being among the industry leaders in the funds they are supplying to the TPA/record keeper.

6) The funds must have at least three years of investment history, with the exception of funds that were already in the Plan under a previous name. Furthermore, the Committee will attempt to choose funds where the investment manager exhibits style (i.e. growth, or value, large cap or small cap) consistency over at least a three-year period. Lastly, the specific fund manager should have managed the fund for at least two-years, with the exception of funds that were already an option in the Plan.

Based on the above criteria, the Committee will choose funds that have consistently outperformed each of their individual peer groups on both a total return and risk-adjusted basis.

## **INVESTMENT OPTION PERFORMANCE STANDARDS**

The Committee will review each of the investment options at least annually to evaluate the option's performance. In reviewing the investment options, the Committee may utilize a Third Party Administrator (TPA) and/or Record keeper to assist in the evaluation process. The investment review will be objective, fair and incorporate statistical analysis provided by an independent third party. The Committee will utilize the following performance benchmarks:

### **1) Actively Managed Funds**

- Each fund shall be benchmarked against their respective peer group as determined by the Morningstar Category. (Morningstar is an independent service that rates mutual funds and variable annuities.) The Morningstar Category identifies funds based on their actual investment styles as measured by their underlying portfolio holdings over the trailing 36 month period.
- **Return Composite:** The Return Composite measures the fund's performance relative to its peer group on a net-of-fee basis. It is calculated by taking the equally weighted average of the 3, 5 and 10 year return percentiles.
- **Sharpe Composite:** The Sharpe Composite measures the fund's risk-adjusted performance relative to its peer group. It is calculated by taking the equally weighted average of the 3 and 5 year Sharpe percentiles.
- **Overall Composite:** The average of the Return Composite and the Sharpe Composite determines the Overall Composite where an Overall Composite above the 66.67% percentile is considered above benchmark.

**Morningstar Category Ratings:** The Category Rating is a quantitative measure of historical risk adjusted returns. This three year rating shows how well a fund has balanced risk and return relative to other funds in the same Morningstar Category. The Morningstar Category Rating is calculated over a three year period on a 1-5 scale. A 3, 4, or 5 rating is considered above benchmark while a 1 or 2 rating is below benchmark.

The top 10 percent of funds in a category receive five stars, the next 22.5 percent receive four stars, and the next 35 percent receive three stars, the next 22.5 percent receive two stars and the bottom 10 percent receive one star. These are all derived from a weighted average of the performance figures associated with its three and five year Morningstar Rating.

- **Current Quarter Overall Rating:** the below matrix combines the Overall Composite with the **Morningstar Rating** to determine if a fund is “Above”, “Neutral” or “Below” for the most recent quarter end time period.

Overall Composite		Morningstar Category Rating	Current Quarter Overall Rating
>66.67%	AND	3, 4 or 5	<b>Above Benchmark</b>
>50.00%	AND	3, 4 or 5	<b>Neutral Rating</b>
<= 50.00%	OR	1 or 2	<b>Below Benchmark</b>

- **Long-Term Rating**

To assess the long-term consistency of performance, the previous 12 quarters are examined and a **Long-Term Rating** is assigned to each investment option based on the matrix below:

Consecutive Quarters Below Benchmark		Total number Quarters	Rolling Analysis
< 4 Quarters	AND	< 7 Quarters	<b>Pass</b>
>= 4 Quarters	OR	>= 7 Quarters	<b>Fail</b>

**2) Passively Managed Variable Funds (Index Funds):** The Index Fund will track its respective index within a 10 basis point range, gross of fees, as measured on an annual basis. This tracking-error range shall be adjusted upward for International and Extended US Market Index funds

**3) Fixed Income Fund (Custom Stable Value Fund):** The Fixed Income Fund shall continue to provide participants with book value accounting, allow participants to make transfers without restriction, and is a Fund whose issuer is rated among the top three

ratings of at least two of the rating services (S&P, Moody's Duff & Phelps, A.M. Best, Fitch, Weiss,)

The Committee recognizes that investment manager's performance can move in cycles over time and performance will not always be superior with respect to an investment option. As such, the Committee will generally monitor funds on a periodic basis, but not less frequently than annually. The Committee will give fund managers sufficient time to remedy any underperformance before the investment option is deleted from the Plans.

While the primary analysis of the investment option will be quantitative, the Committee does reserve the right to make decisions regarding the investment option on other criteria that it believes will be in the best interest of the plan and the participants.

Within the guidelines set forth above, the Committee will evaluate funds with the assistance of the TPA / record keeper. Funds that do not perform at or above its benchmark will be subject to the Plans' policies regarding under performing funds.

## **UNDER PERFORMING FUNDS**

The Committee may take the following steps for funds that are rated "Below" for the current quarter or that "Fail" the Long-Term rating criterion:

- 1) If the Committee has determined that a fund is performing below its benchmarks for the current quarter, the fund may be placed on a "watch list". While a fund is on the "watch list", no action will be taken. Additional information will be gathered as to why the fund is under performing.
  
- 2) Should a fund on the "watch list" subsequently exceed its benchmarks for the current quarter, the fund may be taken off the "Watch list", and will be returned to "good standing". If the fund's performance continues "below" its benchmarks for four consecutive quarters, or seven out of the trailing twelve, the fund has "failed" the Long-Term rolling analysis. The Committee may decide to notify participants of this fact, and the fund may be closed to new contributions. Additionally, the Committee shall offer a new fund in the same asset class. In the event the provider does not offer another investment in the same asset class, the dropped fund monies will be transferred to the stable value fund with the best historical return over the past five years. The Committee at its discretion may also choose to terminate the fund and transfer its assets and future allocations to an existing plan fund. To the extent practical, these fund deletions shall only occur once per calendar year.

## **OTHER CONSIDERATIONS**

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

- a. The option has changed managers, or such a change appears imminent.
- b. The option has had a significant change in ownership or control.
- c. The option has changed its investment mandate or has experienced style drift, departing from the investment objectives or parameters in its prospectus.
- d. The option has experienced substantial portfolio turnover.
- e. The option has violated a SEC rule or regulation.
- f. The option has experienced difficulty in transacting trades, fund transfers, or pricing.
- g. The option has experienced other changes or problems in its procedures, operations, investing, reporting, or lack of employee participation, which in the Committee's view, has or could detract from the objectives of the other options or the Plan itself.
- h. Any other circumstances regarding the options, which the Committee determines is in conflict with this Investment Policy Statement.

## **ADOPTION OF POLICY STATEMENT**

This Investment Policy Statement was recommended to the Board of Supervisors by the Committee on October 17, 2006. This Investment Policy Statement supercedes any previous Investment Policy Statements, and shall remain in force until amended or revoked by the Monterey County Board of Supervisors.

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Chair Board of Supervisors

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Date