

**THE COUNTY OF FRESNO  
DEFERRED COMPENSATION PLAN**

**INVESTMENT POLICY AND PROCEDURES STATEMENT**

**ESTABLISHED SEPTEMBER, 2006**

## PURPOSES

This Investment Policy and Procedures Statement has been developed for the County of Fresno Deferred Compensation Plan to describe:

- Plan objectives
- Investment option categories
- Investment option characteristics
- Standards of investment performance
- Investment fund evaluations
- Blackout Periods
- Prohibited securities
- Disclosure of fees, commissions and charges
- Investment communication to participants
- Investment education
- Review

## PLAN OBJECTIVES

The County of Fresno Deferred Compensation Plan (Plan) is a long-term retirement savings vehicle which is intended to provide a supplemental source of retirement income for eligible participants. The investment options available from the Plan will cover a broad range of investment risk and potential reward appropriate for this kind of retirement savings program. Participants bear the risks and rewards of investment returns that result from the investment options that they select. The investment options (funds) made available will be determined by the County of Fresno Deferred Compensation Committee (Committee) and may be changed as a result of periodic reviews.

The mix of investment options appropriate for a participant depends on the combination of a number of factors, including, among others, age, current income, length of time to retirement, tolerance for investment risk, income replacement/supplement objectives, and a participant's other assets. To permit participants to establish different investment strategies, the plan may offer any number of investment categories, which have varying return and volatility characteristics, in order to allow the participants a broad and diversified portfolio. It is the responsibility of each participant to evaluate the investment options and to select an appropriate mix. A participant should consider, among others, the following risks:

- Volatility:** The risk of significant decreases in account value (including the loss of principal) over relatively short periods of time.
- Accumulation:** The risk of not accumulating sufficient assets to retire.
- Understanding:** The risk of investing for the wrong reasons.
- Diversification:** The risk of concentrating investments and suffering large losses from a single investment category or similar categories that do not perform well.

A risk/reward structure is basic to investments. Generally, those vehicles offering the greatest return over time also carry the highest risk or volatility of return. The inherent conflict between volatility and long-range accumulation can be lessened through diversification among asset classes. To provide participants the opportunity to select risk/reward strategies and to diversify the Deferred Compensation Plan assets, the Plan will offer a number of investment alternatives.

Participants can control their exposure to accumulation and volatility risks by allocating investments among these options. For example, a participant nearing retirement with high sensitivity to volatility risk might invest more heavily in the Stable Income Fund than a participant with many years to retirement. Many other investment options exist. This number and these types were selected because they: 1) each offer a distinct utility to the participants; 2) provide a spectrum of volatility and accumulation choices; and 3) can be administered, communicated and understood within practical constraints of the Plan's resources.

The Committee will attempt to provide plan participants with an array of suitable fund selections with an objective of reducing fund fees, expenses, and administration fees normally associated with these investments.

## DESCRIPTION OF INVESTMENT OPTION CATEGORIES

A **Money Market Option** invests in cash equivalent securities with maturities of less than one year. The average quality of the portfolio must be A1, P1, or AAA. The objective of the fund is to protect underlying principal value and produce a reasonable level of current income. While the volatility risk of this option is the lowest, accumulation risk is the highest.

A **Stable Value Option** invests in book value investments which may include General Account annuity products, Separate Account Annuity products, Guaranteed Accumulation Accounts (GAAs), Guaranteed Investment Contracts (GICs), Bank Investment Contracts (BICs), "Synthetic" GIC arrangements and money market instruments, and may invest in intermediate term fixed income securities with a duration of 5 years or less. Investments may either be made directly or through pooled arrangements. The objective of the fund is to provide higher income than a money market fund while still providing no fluctuation in principal value.

A **Certificate of Deposit Option** with an issuer that guarantees a specific rate of return over a specific period of time. The objective of the fund is to provide guaranteed investment returns with a maximum of safety of principal.

A **Bond Option** invests in cash equivalents and marketable fixed income securities. The average duration of a portfolio should not exceed that of the Lehman Brothers Government/Corporate Bond Index by more than 10%. The average portfolio quality shall be AA (or a comparable rating) or better by Moody's, Standard & Poor's or Fitch's ratings services. Sector and issue concentration guidelines will be dictated by the state policies of the manager of the fund(s).

The investment objective is to provide longer-term preservation of capital while earning a high level of current income. However, principal values may fluctuate over time, primarily in response to changes in interest rates.

A **Balanced Option** invests in several asset classes (typically common stocks, bonds and money market instruments). Investment returns come from both current income and capital changes. Professional investment managers make the asset allocation decisions, and the option can be used by participants who do not wish to self-manage their asset mix. The Balanced Option is expected to produce higher longer-term returns than the Bond Fund option, although volatility may be greater.

Asset allocation, quality and sector concentration guidelines will be dictated by the stated policies of the manager or prospectus of a fund. The investment objective is to provide a diversified investment return of current income and capital appreciation.

A **Large Capitalization\* (Large Cap) Option** invests in those companies that comprise the top 70% of the overall stock market capitalization. This asset class may contain value funds that invest in stocks of companies the investment fund manager believes the stock market undervalues and has the potential for market appreciation. This asset class may also contain growth funds that invests in stocks of companies the fund manager believes will grow at a faster rate than its peers or the corresponding market. This asset class may include funds that are blended to include both value and growth stocks. Stocks in this asset class may provide additional investment growth through the reinvestment of dividends.

A **Medium Capitalization\* (Mid Cap) Option** invests in companies that comprise the next 20% of the overall stock market. This asset class may contain value funds that invest in stocks of companies the investment fund manager believes the stock market undervalues and has the potential for market appreciation. This asset class may also contain growth funds that invests in stocks of companies the fund manager believes will grow at a faster rate than its peers or the corresponding market. This asset class may include funds that are blended to include both value and growth stocks. Mid-sized companies may be less able to weather economic shifts or other adverse developments than larger, more established companies.

A **Small Capitalization\* (Small Cap) Option** invests in companies that comprise the remaining 10% of the overall stock market capitalization. This asset class may contain value funds that invest in stocks of companies the investment fund manager believes the stock market undervalues and has the potential for market appreciation. This asset class may also contain growth funds that invests in stocks of companies the fund manager believes will grow at a faster rate than its peers or the corresponding market. This asset class may include funds that are blended to include both value and growth stocks. Small-sized companies may be less able to weather economic shifts or other adverse developments than larger, more established companies.

An **International / Global Equity Option** - The International Equity Option invests primarily in common stock of established non-U.S. issuers. This fund can be expected to be subject to risk factors not prevalent in domestic markets, including currency risk. The Global Equity Option (aka World Equity Option) invests in common stocks of established non-U.S. issuers as well as domestic common stocks as deemed appropriate by the fund managers. These funds are appropriate for a portion of a participant's account for which additional risk is acceptable in exchange for diversification from options tied solely to domestic markets. Currency fluctuation will contribute to increased return volatility.

An **Index Fund** invests identically to the market index whose return it seeks to duplicate. The objective of an index fund is to provide market diversification and a market average rate of return reflective of the market segment represented by a given index, e.g., the Standard & Poor's 500.

**Asset Allocation Funds (Model Portfolios)** offer an allocation of investments, principally stocks, bonds, and cash or cash equivalents that are appropriate for a given stage of an individual's investment life cycle. An aggressive asset allocation fund will have greater weighting in stocks than a moderate or conservative asset allocation fund. A conservative asset allocation fund will be more heavily weighted toward current income and protection of capital. The objective of an asset allocation fund is to provide a composite rate of return from current income and capital appreciation which is appropriate for a given stage of an individual's investment life cycle.

**Sector or Specialty Funds** invest in more narrow area of the economy such as technology or healthcare industries. These funds are appropriate for a portion of a participant's account for which additional risk is acceptable in exchange for diversification from options tied solely to broader markets. The narrow scope of the fund will contribute to increased return volatility.

**Investment Style** – If possible, in the area of domestic stock funds, the committee will offer the participants alternatives that reflect the different styles in investment management – Growth, Value and Blend.

\*Market capitalization is determined by multiplying the total number of outstanding shares of stock by the market price of the stock. Market capitalization changes with the changes in the price of the stock and increasing or decreasing the outstanding number of shares. Currently, a company is categorized as large if the capitalization is over \$7.5 billion; mid cap is over \$1.25 billion up to \$7.5; small cap is under \$ 1.25 billion. However, this changes with significant swings in the stock market. To maintain consistency the 70%, 20%, 10% is used to determine equity asset classes.

## INVESTMENT OPTION CHARACTERISTICS

	Money Market Option	Certificate of Deposit / Stable Value Option	Bond Option	Balanced Option	Large Cap Option	Mid Cap Option	Small Cap Option	Inter- national/ Global Equity	Index Funds	Asset Allocation Funds	<i>Specialty or Sector Funds</i>
Investment Objective	Stable principal and income growth.	Moderate level of current income with stable principal value.	Higher level of current income and increasing principal appreciation values over the long-term.	Competitive returns from both current income and capital growth.	Moderate capital growth and above average current dividend income.	Long-term growth of capital, less emphasis on current income.	Maximum capital gains, little or no emphasis on income.	Long-term growth of capital, little or no emphasis on income.	Replicate the performance of a specific market index.	Preselected, diversified portfolios, managed as a single fund.	Generally long term capital gains, less emphasis on current income.
Invests Primarily In	Highest quality money market instruments.	General and Separate Account Annuities, GICs, BICs, Money Market instruments, intermediate-term bonds.	Gov't, agency, investment grade corporate bonds.	Common stocks, investment grade bonds and money market instruments.	Common stocks of high quality, relatively mature companies with above average dividends.	Common stocks with prospects for growth superior to that of the broad market.	Common stocks that may be of smaller, higher risk businesses.	Common stocks of non-U.S. issuers with prospects for growth. Global may invest in non-U.S. as well as domestic common stocks.	Domestic stocks or international stocks or bonds, depending on the designated index.	Combinations of international stocks, domestic stocks, bonds, AND stable value, at varying proportions.	Assets in stock of a limited sector of the economy.
Primary Source of Return	Short-term interest income.	Intermediate-term interest income.	Long-term interest income, capital changes.	Capital growth, interest and dividend income.	Capital growth and reinvested dividends.	Capital growth and long-term growth of dividends.	Capital growth.	Capital growth.	Capital growth and/or income, depending on the designated index.	Growth and interest income.	Generally capital growth.

	Money Market Option	Certificate of Deposit / Stable Value Option	Bond Option	Balanced Option	Large Cap Option	Mid Cap Option	Small Cap Option	International Equity	Index Funds	Asset Allocation Funds	Specialty or Sector Funds
<b>Volatility Risk Potential</b>	Lowest	Very low	Moderate	Less than stocks but more than bonds.	Similar average volatility as the S&P 500.	High short-term volatility.	Higher short-term volatility. Periods of several years may elapse before showing superior performance.	Highest short-term volatility. Subject to risk factors not prevalent in the domestic markets, such as currency fluctuations.	From high to moderate short term volatility, depending on the designated index.	Low to moderate, depending on the allocation selected.	Higher short-term volatility. Periods of several years may elapse before showing superior performance
<b>Minimum Participant Investment Time Horizon</b>	Less than one year.	1 to 3 Years	1 to 3 Years	3 to 5 Years	4 to 5 Years	5 Years	5 to 10 Years	5 to 10 Years	3 to 5 years	1 to 5 years, depending on the allocation selected.	5 to 10 Years
<b>Ten Year Accumulation Risk Potential</b>	Highest	Moderate - High	Moderate	Moderate - Low	Low	Low	Low	Low	Moderate to Low, depending on the designated index.	Moderate to Low.	Low
<b>Participant Perception</b>	Safe	Safe. Transfer restrictions need to be carefully communicated.	The interest rate volatility concept may be hard to understand.	Most likely to be misunderstood. Hard to communicate.	Concept easy, differences from Growth Fund are subtle.	Concept easy, actual process sophisticated.	Concept easy. Participants need to understand risks.	Concept may be misunderstood. Risk factors need to be communicated carefully.	Premise of index funds – duplicating performance of a specific market segment – must communicate.	Simple way to invest in a broadly diversified portfolio.	Concept may be misunderstood. Risk factors need to be communicated carefully.



## Standards of Investment Performance

	3 Year Standard	5 Year Standard
<b>Money Market Option</b>	Competing Money Market Funds will be compared between industry providers.	Competing Money Market Funds will be compared between industry providers.
<b>Stable Value Option</b>	Competing Stable Value Funds will be compared between industry providers.	Competing Stable Value Funds will be compared between industry providers.
<b>Bond Option</b>	Total time-weighted rates of return that match or exceed the average return of a universe of fixed income funds.	Total time-weighted rates of return that match or exceed the average return of a universe of fixed income funds.
<b>Balanced Option</b>	Total time-weighted rates of return that match or exceed the average return of a universe of balanced funds with comparable asset allocation policies.	Total time-weighted rates of return that match or exceed the average return of a universe of balanced funds with comparable asset allocation policies.
<b>Large Cap Option</b>	Total time-weighted rates of return that match or exceed the average return of a universe of large cap funds.	Total time-weighted rates of return that match or exceed the average return of a universe of large cap funds.
<b>Mid Cap Option</b>	Total time-weighted rates of return that exceed the average return of a universe of mid cap funds.	Total time-weighted rates of return that exceed the average return of a universe of mid cap funds.

# INVESTMENT FUND EVALUATIONS

## POLICY:

The Committee retains the authority to periodically, but no less than annually, evaluate and deselect investment funds. Three (3) and five (5) year Standards of Investment Performance will be applied to all investment funds in the Plan. Each standard shall apply independently to the portfolio of each investment fund and is expected to be achieved net of investment management fees and expenses but not administrative, marketing, and enrollment fees, if any. For funds without comparable indices or peer groups, such as general account products, the Committee will compare the performance to other investment instruments in the market.

The evaluation process will be supported by data, which is derived from Morningstar, and include comparison of returns, expenses, volatility, and risk adjusted returns from the average of the A shares of funds within the peer group of the fund being reviewed.

If an investment fund fails to meet the minimum standards of investment performance outlined in this document, the Committee may take the following steps. The Committee may, in its discretion, if circumstances warrant, proceed directly to Step 2.

*Exceptions* – In certain circumstances there may be funds, generally specialty or niche funds that may have limited options within the investment vendor contract's selection. If these/this fund(s) does not meet the committees' investment standards, the committee at its discretion can keep the fund in its line up. An example of such fund would be a "sociably responsible" fund or a "green" fund.

## PROCEDURE:

Step 1. The investment fund should immediately be placed on a one-year probation. Retention at the end of that one-year period will be contingent on the following:

- The fund should perform above the average of its investment management universe over three-year periods; or
- The fund should perform in the top half quartile of its investment management universe over the past one-year period; and
- Risk-adjusted returns should not exceed 130% of the relative index over the three-year period; and
- Performance over these periods will be reviewed to justify retention.

Investment funds that do not satisfy the retention criteria at the end of that one-year period will be considered for replacement – see Step 2.

Step 2. A fund search may be initiated and a replacement fund selected. Plan assets already deposited with the dropped fund will have a transition period of a length set by the Committee, but not less than **30 days**, in which he or she may transfer their assets to the replacement fund or a fund option of the participant's choice. During the transition period, reminders will be sent to participants monthly prior to eliminating the fund.

In the event a participant does not voluntarily select a replacement fund(s) by the end of the transition period, the Committee will direct the provider to transfer the current balance of the dropped fund to the replacement fund within the asset class with the same provider. In the event the same provider does not offer another investment in the same asset class, the dropped fund will be transferred to the stable value fund (**General Account with Hartford**) of that provider.

Other reasons for probationary review of investment funds may include:

1. Change of investment manager by fund provider
2. Change of subadvisor
3. Significant change in ownership or control
4. Significant change in fund management style or drift
5. Substantive change in portfolio turnover that significantly exceeds the fund's history
6. Any violation of SEC rules or regulations or breach of fiduciary duty
7. Operational difficulties concerning fund transfers or pricing
8. Excessive costs or trading practices
9. Negligible use by participants

## **BLACKOUT PERIOD**

### **POLICY:**

In accordance with the Sarbanes-Oxley Act of 2002, the Plan will give plan participants a minimum of 30-day advance notice of “blackout periods” affecting their rights to direct investments, take loans (if available) or obtain distributions. Blackout periods may occur when plans change record-keepers, record-keeping systems or investment options. Individual participants will receive a blackout notice that contains, among other things:

- The reasons for the blackout period,
- A description of the rights that will be suspended during the blackout period,
- The start and end dates of the blackout period,
- A statement advising participants to evaluate their current investments based on their inability to direct or diversify assets during the blackout period.

## **PROHIBITED SECURITIES (DERIVATIVE GUIDELINES)**

### **CASH EQUIVALENT HOLDING**

### **POLICY:**

Derivatives generally refer to financial instruments that derive their values from underlying cash market investments. Examples of derivatives include, but are not limited to, financial futures, forwards, options, options on futures, collateralized mortgage obligations and swaps.

The investment manager(s) shall not, in the money market option or the cash portion of any other option, enter into a derivatives contract, purchase securities on margin, or sell short unless expressly authorized to do so in writing by the Committee.

## **DISCLOSURE OF FEES, COMMISSIONS AND CHARGES**

### **POLICY:**

All fees, commissions and charges for each selected investment option must be fully disclosed to the Committee before the option can be made available to plan participants. That is, in its review of a fund's performance history, the Committee must be shown the fund's gross performance less all applicable fees, commissions and charges, and the resulting net return.

In addition, these fees, commissions and charges will be disclosed to all participants at enrollment and at any other time as appropriate. It will be disclosed to plan participants the nature of all variances between gross return and net return.

## **INVESTMENT COMMUNICATIONS TO PARTICIPANTS**

### **POLICY:**

Information about each investment option will be given or made available to Plan participants to help them to make informed investment choices. The Providers shall provide at least quarterly statements of fund performance to each participant.

Upon request, copies of investment fund prospectuses or similar equivalent information will be provided to participants as well as such other information as the Committee has available such as a list of underlying investments for a given fund.

## **INVESTMENT EDUCATION**

### **POLICY:**

It is the Committee's objective to provide participants with ongoing investment education. The purpose of the investment education program is to provide information and tools to assist in the development of a personal investment strategy for employees and facilitate the achievement of savings and retirement goals.

## REVIEW

### POLICY:

It is the intention of the Committee to review this document at least every three years and make necessary amendments.

If at any time a fund investment manager or provider feels that these policy standards cannot be met, or that the guidelines constrict management, the Committee should be notified in writing so that recommendation for changing the policy, if deemed appropriate, can be made by the Committee to the County.

Signed and dated in the County of Fresno on September 22, 2006:

Deferred Compensation Plan Committee:

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Bart Bohn, County Administrative Officer

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Vicki Crow, Auditor-Controller/Treasurer-Tax Collector

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Ralph Jimenez, Director of Personnel Services

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Bill Mar, Member-at-Large

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Roberto Pena, Member-at-Large

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Robert Werner, Member-at-Large