

# Q1 2017



**WISCONSIN**  
— SELECT —

Quarterly Due  
Diligence  
Monitor



**THE APPLETON GROUP, LLC**

INVESTMENT MANAGEMENT · RETIREMENT PLANNING  
CORPORATE 401(k) PLANS · MARKET RESEARCH

# OVERVIEW

Investment Stewards are looking for universally accepted standards of practice to aid them in the performance of their fiduciary duties.

Adherence to a standard can be the foundation for the trust placed in Stewards by their grantors, whether trustees of private trusts, employee benefit plans, foundations, endowments, or other institutional portfolios.

Standards of excellence offer a consistency of interpretation and implementation, which facilitates the transfer of knowledge between the Steward, beneficiaries, Advisors, vendors, and regulators.

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“We cannot say that [Defendant] was imprudent merely because the Balanced Fund lost money; such a pronouncement would convert the Balanced Fund into an account with a guaranteed return and would immunize plaintiffs from assuming any of the risk of loss associated with their investment. ‘The fiduciary duty of care,’ as the district court so cogently stated it, ‘requires prudence, not prescience.’”

*Debruyne v. Equitable Life Assurance Society of the United States*, 920 F.2d 457, 465 (7th Cir. 1990) (Wood).

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The legal and performance pressures endured by Investment Stewards are tremendous, and come from multiple directions and for various reasons. Complaints and/or lawsuits alleging fiduciary misconduct are likely to increase. However, contrary to widespread belief, fiduciary liability is not determined by investment performance, but in whether a prudent process was followed.

In that regard, a fiduciary often will confuse responsibility with liability. An Investment Steward to a pension plan or foundation, for example, can never delegate away fiduciary responsibility. Fiduciary duties can be shared with other “co-fiduciaries,” such as Investment Managers, but can never be handed over completely to another party. Although the Investment Steward remains responsible as a fiduciary, the Steward can substantially mitigate the risk of liability by following prudent investment practices.

Investment products and strategies are never inherently prudent or imprudent. The propriety of a fiduciary’s actions is determined largely by evidence of procedural prudence—the extent to which the fiduciary assembled, evaluated, and acted upon pertinent information in a manner consistent with generally accepted investment theories. In fact, both case law and regulatory guidance suggest that fiduciaries are permitted considerable latitude in providing investment advice or making investment decisions when they can show they engaged in a prudent process. Thus, while even the most aggressive and unconventional investment can meet the standard if arrived at through a sound process, the most conservative and traditional product may be inappropriate if a sound process was not implemented.

“I know of no case in which a trustee who has happened—through prayer, astrology or just blind luck—to make (or hold) objectively prudent investments ... has been held liable for losses from those investments because of his failure to investigate and evaluate beforehand. Similarly, I know of no case in which a trustee who has made (or held) patently unsound investments has been excused from liability because his objectively imprudent action was preceded by careful investigation and evaluation. In short, there are two related but distinct duties imposed upon a trustee: to investigate and evaluate investments, and to invest prudently.”

*Fink v. National Savings and Trust Co.*, 772 F.2d 951, 962 (D.C. Cir. 1985) (Scalia concurring in part and dissenting in part).

It is important to note, however, that procedural prudence alone does not complete a fiduciary's obligations. Investments must be aligned with the cash flow requirements and investment objectives of the portfolio. Thus, it would be objectively imprudent for a fiduciary to select investments or an investment strategy that would prevent the portfolio's objectives and requirements from being achieved.

## FOR THE INVESTMENT STEWARD, THE KEY BENEFITS ASSOCIATED WITH APPLYING THE PRUDENT PRACTICES OUTLINED IN THIS PROCESS INCLUDES:

- 1. Risk management:** Most investment litigation involves the alleged omission of certain fiduciary practices/or prudent investment procedures, as opposed to the commission of certain acts. This process incorporates a scoring system to help the Investment Steward ensure that the investment decisions are prudently managed.
- 2. Fulfillment of fiduciary responsibilities:** As much as 80% of the nation's liquid, investible wealth is managed by trustees and investment committees. Investment Stewards should be able to demonstrate fiduciary skills, knowledge, and investment awareness as well as a fundamental understanding of the law to effectively delegate and share responsibility with other fiduciaries while providing effective oversight to serve their beneficiaries.
- 3. Institutional reputation:** “Fiduciary responsibility” has become the watchword with trustees, investment committee members, and even retail investors. Investment Stewards who can communicate clearly how they provide responsible oversight of the management of Investment Advisors and investment decisions to a defined fiduciary standard of excellence may enable their entities to enjoy a major advantage over competing entities in the gathering of donations and management of assets.
- 4. Increased efficiency and effectiveness:** An Investment Steward is expected to apply the skill, knowledge, diligence, and good judgment of a professional. The fi360 Prudent Practices provide a consistent framework to help the Investment Steward not only achieve regulatory compliance but adopt best professional practices for sound portfolio oversight. By implementing a comprehensive process to fulfill fiduciary obligations the Steward can establish a regimented business model that is specifically designed to serve the best interests of its beneficiaries.

## THE PRACTICES AND CRITERIA ARE ORGANIZED UNDER A FOUR-STEP FIDUCIARY QUALITY MANAGEMENT SYSTEM.

The steps are consistent with the global ISO 9000 Quality Management System standard, which emphasizes continual improvement to a decision-making process:

### Step 1: Organize

During the organize stage, the investment fiduciary identifies laws, governing documents, and other sources of guidance for fiduciary conduct.

### Step 2: Formalize

During the formalize stage, the investment fiduciary identifies the substantive investment objectives and constraints, formulates asset allocation strategies, and adopts an investment policy statement to guide the investment decision-making process.

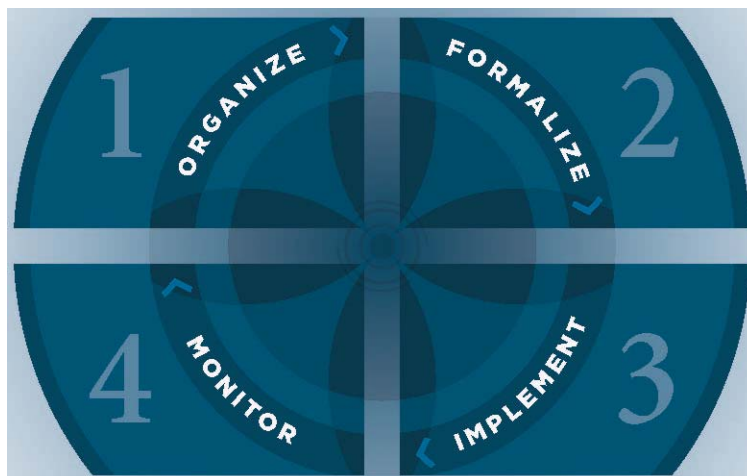
### Step 3: Implement

The implement stage is when investment and service provider due diligence is preformed and decisions about investment safe harbors are made.

### Step 4: Monitor

During the monitoring stage, the investment fiduciary engages in periodic reviews to ensure that the investment objectives and constraints are being met and that the Prudent Practices are consistently applied.

**FIDUCIARY QUALITY MANAGEMENT SYSTEM**  
(Analogous to the ISO 9000 QMS Continual Improvement Process)



Each Practice is backed by legal substantiation based on statutes, case law, regulations and regulatory guidance. The major statutes and supporting law that are covered by the substantiation include:

- **ERISA** – The Employee Retirement Income Security Act of 1974, a federal law that impacts fiduciary responsibilities related to qualified retirement plans. Requirements under ERISA for qualified retirement plans are administered by the Department of Labor’s Employee Benefits Security Administration, which issues regulations and regulatory guidance that further governs fiduciary obligations.
- **IAA** – The Investment Advisers Act of 1940, a federal securities law that governs the regulation of investment advisers and their fiduciary responsibilities. The IAA is administered by the Securities and Exchange Commission (SEC), which issues regulations and regulatory guidance affecting investment advisers and their fiduciary responsibilities. State statutes similar to the IAA are typically administered by individual state securities commissioners.

The following three laws are uniform acts developed and proposed by the National Conference of Commissioners on Uniform State Laws (NCCUSL) for states to consider for adoption. To identify whether a state has adopted the model act, please visit NCCUSL’s website ([uniformlaws.org](http://uniformlaws.org)). If a particular state is not identified as having adopted the model act, then the Advisor should seek guidance from qualified legal counsel on the fiduciary standard of care that is applicable to that particular state, and whether any of the fiduciary practices covered in this guide are not applicable.

- **UPIA** – Uniform Prudent Investor Act, a widely-adopted state law that covers fiduciary responsibilities related to private trusts. The UPIA was released in 1994 and subsequently endorsed by the American Bar Association and American Bankers Association. More than 40 states and the District of Columbia generally have adopted the model law, although differences may exist from state to state. The UPIA serves as a default standard for investment activities of private trusts. Typically, the provisions of a private trust prevail. However, if a trust document is silent regarding a particular fiduciary duty, such as the duty to diversify, then — according to the terms of the Act — the provisions of the UPIA apply.
- **UPMIFA** – Uniform Prudent Management of Institutional Funds Act, a state law that impacts foundations, endowments, and government sponsored charitable organizations. UPMIFA was released in July 2006 and has been adopted by most states and the District of Columbia.
- **UMPERSA** – Uniform Management of Public Employee Retirement Systems Act, a model state law that impacts state, county, and municipal retirement plans. UMPERSA was released in 1997 and may apply to state, county, and municipal retirement plans. At the date of publication, Maryland and Wyoming are the only states that have formally adopted the act.

# GLOBAL FIDUCIARY PRECEPTS

If an Investment Steward were to read all of the laws defining fiduciary obligations, the Steward would discover seven common requirements.

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WE HAVE ADOPTED THESE SEVEN REQUIREMENTS AS “GLOBAL FIDUCIARY PRECEPTS”:

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1. Know standards, laws, and trust provisions
2. Diversify assets to specific risk/return profile
3. Prepare investment policy statement
4. Use “prudent experts” (for example, as Investment Manager) and document due diligence
5. Control and account for investment expenses
6. Monitor the activities of “prudent experts”
7. Avoid prohibited transactions and avoid or manage other conflicts of interest in favor of the portfolio

We suggest that the Investment Steward utilize the seven Global Fiduciary Precepts, as these represent the best probing questions a Steward could ask at the onset of the investment process:

- What laws and governing documents apply to guide your decision-making processes?
- How was the portfolio’s current asset allocation determined?
- Is there an IPS? When was the last time it was updated?
- What type of due diligence was performed on the investment allocations that currently exist in the portfolio, or other available investment options?
- Are you sure the fees and expenses paid to Investment Managers and other service providers are fair and reasonable?
- What type of periodic monitoring is applied to the portfolio?
- Is it clearly defined which service providers are serving in a fiduciary capacity versus which are not? How are conflicts of interest being resolved in the portfolio’s favor?

This guide will further explore the Steward’s fiduciary responsibilities under the Global Fiduciary Precepts and in the context of the Practices and Criteria.

# INTRODUCTION

Step 4 of fi360's Fiduciary Quality Management System, Monitoring a company-sponsored retirement plan, can be labor-intensive, since it is ongoing and may involve a need to respond to changes in the economic or market cycle, the pricing of investment services, retirement plan arrangements, and in circumstances directly impacting the financial situation or outlook of the portfolio. No one should be lulled into thinking that the 'heavy lifting' was done in the previous three steps and the portfolio is now on 'auto pilot,' marked only by periodic re-balancing, quarterly performance reports and routine meetings.

For the investment fiduciary, the starting point of monitoring is working backwards through the four-step Fiduciary Quality Management System. The logic is simple: activities involved in monitoring are dependent upon what was done in the first three Steps. As you work your way back through the process, you will typically analyze what you and your advisor did in steps 3, 2, and 1 of the fi360 Prudent Practices for Investment Stewards handbook.

You will recall that the focus of Step 3, Implement, involves a due diligence process used to select Investment Managers and service providers. Generally speaking, the criteria used to select managers and service providers are the same criteria used in monitoring.

In the Formalize step we focused on establishing an appropriate asset allocation strategy and preparing the investment policy statement. The asset allocation strategy is the cornerstone of the IPS, which is the business plan for management of the plan or portfolio.

It may be necessary to go back to the Organize step to review the laws, regulations and documents used to establish the governing principles for the portfolio. Reviewing the process in this way should allow the Investment Steward at some point to step back and self-assess his or her own effectiveness in adhering to establishing best practices and ultimately establishing a strong fiduciary culture in the organization.

Step 4 is where many fiduciary breaches occur, and the cause may be inadequate preparation and execution in the earlier parts of the investment process, resulting in errors of omission which are more common than acts of commission. For example, a poorly written investment policy statement undermines effective monitoring. Another common form of an omission is failure to follow through on established policies and procedures.

Monitoring requires the Investment Steward to conduct or oversee quantitative and qualitative reviews. Quantitative reviews, among other things, involve a comparison of investment performance to appropriate benchmarks and portfolio objectives in the IPS. Qualitative reviews of Investment Managers and service providers include the need to be aware of, and consider things such as: 1) trade press or news reports on turnover in management; 2) repeated enforcement actions taken against the investment organization or its parent; and 3) the quality of responses to requests for information.

Policies and procedures governing trading practices and proxy voting of separate account managers also need to be periodically reviewed.

One of the seven global fiduciary precepts is to control and account for investment expenses. This is a critical part of monitoring that is getting more and more scrutiny from regulators and the courts. The Investment Steward needs to ensure, with the help of the Investment Advisor, that all paid service providers in the investment process are identified, along with their compensation amounts, and that a determination is made that the amounts paid are reasonable in light of the services provided.

Finally, Step 4 is where the fiduciary duty of care takes on special meaning with respect to assessing the Investment Steward's overall effectiveness in meeting his or her fiduciary obligations. Planned fiduciary assessments conducted at regular intervals provide for this needed review.

# THE APPLETON GROUP DUE DILIGENCE SCORING SYSTEM

## Risk-Acceptance Lineup

The Appleton Group Due Diligence Scoring System evaluates various investments that are suitable for defined contribution retirement plans. Penalty points are assigned to an investment vehicle when a specific shortfall is identified. A high penalty score indicates an underperforming investment that will be examined by The Appleton Group, who will then determine whether to place the investment on a watch list or remove it from the plan. Investments in the risk-acceptance lineup are funds allocated to particular markets with the intent to track or outperform their corresponding benchmarks on a year-to-year basis. The following metrics analyze an investment's operational stability, fees, performance, and risk to determine suitability<sup>1</sup>:

**Stability:** The lead portfolio manager should have at least 5 full years of experience managing the fund.

- 5 point penalty if lead portfolio manager has less than 5 years of experience managing specified fund

**Stewardship:** The fund should receive high ratings for its corporate culture, board quality, manager incentives, fees, and regulatory compliance.

- 5 point penalty if the investment's Morningstar Stewardship Grade is "D" or "F"

**Fund Size:** The fund should have at least \$75M under management to ensure adequate liquidity of the investment.

- 5 point penalty if the investment has less than \$75 million in assets

**Style Consistency:** The investment's value-growth and size metrics should not drift over time.

- 5 point penalty if the investment's Style Consistency Metric is greater than 9
  - Additional 5 point penalty if the investment's Style Consistency Metric is greater than 29

**Fund-level Net Flow:** The investment's 6 Month Fund-level Net Flow should not have outflows of greater than 10% of the fund's asset base.

- 5 point penalty if the 6 Month Fund-level Net Outflow is more than 10%

**Expense Ratios/Fees Relative to Peers:** The investment's fees should lower than the average of its peer group. The Net Expense Ratio is used for the evaluation of mutual funds, ETFs and collective investment funds, which includes all fund management fees, 12b-1 fees, administrative fees, and all other asset-based fees incurred by the fund, except brokerage fees.

- 5 point penalty if the investment's Net Expense Ratio is greater than the average of its peer group.
  - **Compensated Net Expense Ratio:** additional 5 point penalty if the investment's Net Expense Ratio is greater than the average of its peer group and the difference in expense ratios is not exceeded by equal or higher 3-year average rolling return compared to its peer group.

**3-Year Rolling Returns:** The investment's 3-year rolling returns<sup>2</sup> versus its respective category.

- 10 point penalty if the investment's average 3-year rolling returns are below its respective category
- 15 point penalty if the investment's worst performance during the 3-year rolling periods are below its respective category
- 10 point penalty if the investment's success rating,<sup>3</sup> based on 3-year rolling performance, is below that of its respective category

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<sup>1</sup> Source: Morningstar Office; data as of 03/31/17. Performance statistics are shown for specific investments and are not intended to represent actual investor returns.

<sup>2</sup> 3-year rolling performance data is based on 10 years of historic data unless otherwise noted. Period inception date for rolling 3-year returns is 06/2006

<sup>3</sup> Where success rate is defined as the number of periods during the data range that had positive returns divided by the total number of periods in the data range



# THE APPLETON GROUP DUE DILIGENCE SCORING SYSTEM

**Risk Relative to Peers:** The investment's 5-Year Morningstar Risk Rating should not be above average unless that risk is being compensated for with higher average 3-year rolling returns in comparison to the category.

- 10 point penalty if the investment's 5-Year Morningstar Risk Rating is "Above Average" and the average 3-year rolling returns are below those of the category.
- 15 point penalty if the investment's 5-Year Morningstar Risk Rating is "High" and the average 3-year rolling returns are below those of the category.

**Return per unit of Risk:** Investments should reward investors for the amount of risk associated with the investment.

- 5 point penalty if the 5-year Sharpe Ratio is less than .9

## Risk-Acceptance Lineup: Strategic Opportunities

Investment options that receive a due diligence score of 76 or higher may be experiencing recent short/mid-term underperformance or other factors that may warrant corrective action be taken. Wisconsin Select has created a "penalty box" feature to hold underperforming candidates as part of a diversified model which plan participants can choose to use.

Named the "Strategic Opportunities Model," this strategy seeks to invest in established but recently underperforming strategies that may be poised to outperform assuming reversion to the mean historic average for that strategy. All funds that comprise this model are gauged using our stand-alone Risk-Acceptance Lineup data points cited above. In the opinion of Appleton Group, Candidates must continue to demonstrate adequate style consistency, manager continuity and fiduciary standards to be considered.

Candidates may be moved to the stand-alone investment lineup at the discretion of Appleton Group fiduciary staff in recognition of a due diligence score of 50 or higher.

Candidates may be eliminated from Strategic Opportunities Model or from the investment lineup altogether at the sole discretion of Appleton Group.

**Stability:** The lead portfolio manager should have at least 3 full years of experience managing the fund.

- 5 point penalty if lead portfolio manager has less than 3 years of experience managing specified fund

**Style Consistency:** The investment's value-growth and size metrics should not drift over time.

- 5 point penalty if the investment's Style Consistency Metric is greater than 9
  - Additional 5 point penalty if the investment's Style Consistency Metric is greater than 29

**Fund Size:** The fund should have at least \$50M under management to ensure adequate liquidity of the investment.

- 5 point penalty if the investment has less than \$50 million in assets

**Fund-level Net Flow:** The investment's 6 Month Fund-level Net Flow should not have outflows of greater than 10% of the fund's asset base.

- 5 points if the 6 Month Fund-level Net Outflow is more than 10%

**Expense Ratios/Fees Relative to Peers:** The investment's fees should not be in the bottom quartile (most expensive) of its peer group. The Prospectus Net Expense Ratio is used for the evaluation of mutual funds and ETFs, which includes all fund management fees, 12b-1 fees, administrative fees, and all other asset-based fees incurred by the fund, except brokerage fees.

- 10 points if the investment's Prospectus Net Expense Ratio is in the bottom quartile

# THE APPLETON GROUP DUE DILIGENCE SCORING SYSTEM

**3-Year Rolling Returns:** The investment's 3-year rolling returns<sup>4</sup> versus its respective category.

- 10 point penalty if the investment's average 3-year rolling returns are below its respective category
- 15 point penalty if the investment's worst performance during the 3-year rolling periods are below its respective category
- 10 point penalty if the investment's success rating,<sup>5</sup> based on 3-year rolling performance, is below that of its respective category

**Return per unit of Risk:** Risk-managed investments should seek to reward investors for the amount of risk associated with the investment.

- 5 points if the 5-year Sharpe Ratio is less than .9

**Risk-adjusted Performance Relative to Peers:** The investment's Morningstar Risk-Adjusted Return should not rank in the bottom half of investments in its peer group for a 5-year period.

- 5 points if the investment ranks in the bottom half of peer group investments during the last 5 years
  - Additional 5 points if the investment ranks in the bottom quartile of peer group investments during the last 5 years

**Value Added by Investment Manager:** A primary goal of risk-managed portfolios is to deliver returns exceeding expectations given the amount of an investment's market risk.

- 5 points if the investment's 5-year Alpha is negative

**Market Risk:** Risk-managed strategies should not expose investors to a large amount of market risk.

- 5 points if the 5-year Beta is greater than 1.1

## Risk-Acceptance Lineup: Innovation

Investment options which do not have a 5-year minimum performance history may be considered for the "Innovative Talent Model." This model is comprised of multiple strategies offered by emerging managers and is designed to incubate innovative strategies which may at some time in the future be considered for our stand-alone risk-acceptance or risk-managed lineup. As emerging managers typically do not have extensive quantitative metrics to measure, candidates are excluded from standard quantitative due diligence metrics and are instead considered based on a subjective 4-part evaluation process. Criteria include but are not limited to: investment process, management personnel, platform availability, and performance since strategy inception.

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<sup>4</sup> 3-year rolling performance data is based on 10 years of historic data unless otherwise noted. Period inception date for rolling 3-year returns is 06/2006

<sup>5</sup> Where success rate is defined as the number of periods during the data range that had positive returns divided by the total number of periods in the data range

# THE APPLETON GROUP DUE DILIGENCE SCORING SYSTEM

## Risk-Managed Lineup

The Appleton Group Due Diligence Scoring System evaluates risk-managed investment strategies that may be suitable for retirement plans. Penalty points are assigned to an investment vehicle when a specific shortfall is identified. A high penalty score indicates an investment that will be examined by The Appleton Group, who will then determine whether to place the investment on a watch list or remove it from the plan. Investments in the risk-managed lineup are intended to produce positive returns during favorable market environments while minimizing excess risk during unfavorable market environments. Typically, they aim to maximize returns at a given risk level over multiple market cycles instead of attempting to beat benchmarks on a year-to-year basis. The following metrics<sup>6</sup> analyze an investment's operational stability, fees, performance, and risk to determine suitability:

**Stability:** The lead portfolio manager should have at least 5 years of experience managing the fund to ensure the fund's strategy will be executed properly.

- 5 point penalty if lead portfolio manager has less than 5 years of experience managing specified fund

**Expense Ratios/Fees Relative to Peers:** The investment's fees should be lower than the average of its peer group. The Net Expense Ratio is used for the evaluation of mutual funds, ETFs, and collective investment funds which includes all fund management fees, 12b-1 fees, administrative fees, and all other asset-based fees incurred by the fund, except brokerage fees.

- 5 point penalty if the investment's Net Expense Ratio is greater than the average of its peer group
  - **Compensated Net Expense Ratio:** additional 5 point penalty if the investment's Net Expense Ratio is greater than the average of its peer group and the difference in expense ratios is not exceeded by equal or higher 3-year average rolling return compared to its peer group<sup>7</sup>

**Predictability of Returns:** Retirement plan participants benefit from having more predictable returns as they save for retirement.

- 5 point penalty if the investment's 5-year standard deviation exceeds the average of its peer group

**Market Risk:** Risk-managed strategies should not expose investors to a large amount of market risk.

- 5 point penalty if the 5-year Beta is greater than 1.1
  - Additional 5 point penalty if Beta is greater than 1.20
  - Additional 5 point penalty if Beta is greater than 1.30

**Market Dependence:** Historically, a high degree of correlation with the stock market carries a high degree of risk, especially for investors nearing the age of retirement.

- 5 point penalty if the investment's 5-year R-squared exceeds 90%

**Return per unit of Risk:** Risk-managed investments should seek to reward investors for the amount of risk associated with the investment.

- 5 point penalty if the 5-year Sharpe Ratio is less than .9

<sup>6</sup> Source: Morningstar Research; data as of 03/31/17. Performance statistics are shown for specific investments and are not intended to represent actual investor returns.

<sup>7</sup> I.E. If investment A has a net expense ratio of 1.1% and the peer group's average net expense ratio is 1% then investment A's 3-year average rolling return would have to be at least .1% higher than that of the peer group.

# THE APPLETON GROUP DUE DILIGENCE SCORING SYSTEM

**Value Added by Investment Manager:** A primary goal of risk-managed portfolios is to deliver returns exceeding expectations given the amount of an investment's market risk.

- 5 point penalty if the investment's 5-year Alpha is negative

**3-Year Rolling Returns:** The investment's 3-year rolling returns data versus its respective category.

- 10 point penalty if the investment's average 3-year rolling returns are below its respective category
- Additional 15 point penalty if the investment's worst performance during all 3-year rolling periods are below its respective category
- Additional 10 point penalty if the investment's success rate, based on 3-year rolling performance, is below that of its respective category

**Self-dealing:** Self-dealing exists when either (or both) of the following criteria are met: 1) the underlying sub-accounts are proprietary; 2) the advisor and/or vendor receive additional compensation (either hidden or disclosed) from the underlying sub-accounts. To limit this conflict of interest, proprietary sub-accounts should not exceed 50% of the investment's underlying holdings.

- 5 point penalty if more than 50% of the investment's assets are proprietary funds
  - Additional 5 point penalty if more than 75% of the investment's assets are proprietary funds

# THE APPLETON GROUP DUE DILIGENCE SCORING SYSTEM

## How to Interpret The Appleton Group Due Diligence Score:

The Appleton Group Due Diligence Score measures each investment's suitability for a fiduciary account on a scale of 0-100.

### Due Diligence Score Color Code

#### Due Diligence Score: 0

No fiduciary due diligence shortfalls.

#### Due Diligence Score: 1-25

The investment has only a few shortfalls. Every investment will experience occasional, short-term underperformance. Therefore, action may not be required.

#### Due Diligence Score: 26-50

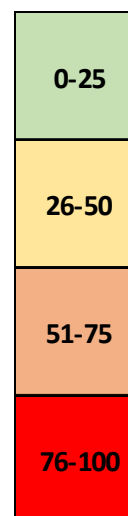
The investment has noteworthy shortfalls. If already in use, the advisor may evaluate the investment to determine whether or not to add it to the watch list and document its shortfalls. If considered in a search, the investment may be considered an inappropriate choice.

#### Due Diligence Score: 51-75

The investment has considerable shortfalls. The advisor will evaluate the investment to determine whether or not to add it to the watch list or find a suitable alternative. If the score improves in subsequent time periods, action may not be necessary.

#### Due Diligence Score: 76-100

The investment has significant shortcomings. The advisor will strongly consider removing the investment from the stand-alone lineup and consider adding it to the Strategic Opportunities Model (penalty box feature). Under further analysis, there may be special cases where a high score is considered short-term and justifiable given the investment's purpose in the plan.



# TOTAL DUE DILIGENCE SCORE

## RISK-ACCEPTANCE LINEUP

Name	Ticker	Total Due Dilligence Score
<b>Large Blend Model</b>		<b>12.5</b>
Convergence Core Plus Institutional	MARNX	25
Dana Large Cap Equity Institutional	DLCIX	25
Schwab US Broad Market ETF™	SCHB	0
<b>Large Growth Model</b>		<b>6.3</b>
Nicholas	NICSX	10
Wells Fargo Premier Large Co Gr Inst	EKJYX	15
Schwab US Large-Cap Growth ETF™	SCHG	0
<b>Large Value Model</b>		<b>11.3</b>
Madison Dividend Income Y	BHBFX	0
Madison Large Cap Value Y	MYLVX	45
Schwab US Large-Cap Value ETF™	SCHV	0
<b>Mid Growth Model</b>		<b>1.3</b>
Baird MidCap Inst	BMDIX	5
Nicholas II I	NCTWX	0
Schwab US Mid-Cap ETF™	SCHM	0
<b>Mid Value Model</b>		<b>10.0</b>
Heartland Select Value Investor	HRSVX	20
Wells Fargo Special Mid Cap Value Inst	WFMIX	0
Reinhart Mid Cap PMV Adv	RPMVX	40
Schwab US Mid-Cap ETF™	SCHM	0
<b>Small Growth Model</b>		<b>26.3</b>
Broadview Opportunity	BVAOX	15
Nicholas Limited Edition I	NCLEX	10
Vanguard Small-Cap Growth ETF	VBK	40

Name	Ticker	Total Due Dilligence Score
<b>Small Value Model</b>		<b>27.5</b>
Wells Fargo Special Small Cap Value Inst	ESPNX	25
Vanguard Small-Cap Value ETF	VBR	30
<b>Global Equity</b>		<b>16.3</b>
Artisan Global Equity Institutional**	APHHX	25
Madison International Stock Y	MINYX	20
Schwab International Equity ETF™	SCHF	10
<b>High Yield Bond Model</b>		<b>18.3</b>
Nicholas High Income I	NCINX	10
Wells Fargo Short-Term Hi Yld Bd Inst	STYIX	10
Baird Core Plus Bond Inst	BCOIX	0
SPDR® Blmbg Barclays High Yield Bd ETF	JNK	30
<b>Aggregate Bond Model</b>		<b>13.8</b>
Baird Aggregate Bond Inst	BAGIX	0
Thompson Bond	THOPX	25
Schwab US Aggregate Bond ETF™	SCHZ	15
<b>Alternatives Model</b>		<b>13.3</b>
Plumb Balanced*	PLBBX	60
Madison Covered Call & Equity Income A	MENAX	5
RidgeWorth Cap Innvts Gbl Rs&Infrs I	INNNX	15
Schwab US Large-Cap Growth ETF™	SCHG	0

# TOTAL DUE DILIGENCE SCORE

## RISK-MANAGED LINEUP

Name	Ticker	Total Due Dilligence Score
<b>Allocation</b>		
Age-Based 18-29***	N/A	10
Age-Based 30-39***	N/A	5
Age-Based 40-49***	N/A	10
Age-Based 50-59***	N/A	10
Age-Based 60+***	N/A	0

\*\*\*See Managed Model/General Disclosures on pages 35-36

## 4.1 PERFORMANCE MONITOR

Periodic reports compare investment performance to appropriate index, peer group, & investment policy statement objectives.

1. The performance of each investment option is periodically compared against an appropriate index, peer group, and any other performance-related due diligence criteria defined in the investment policy statement.
2. “Watch list” procedures for underperforming Investment Managers are documented, and consistently applied.
3. Rebalancing procedures are reasonable, documented, and consistently applied.

The monitoring function extends beyond a strict examination of performance. By definition, monitoring occurs across all policy and procedural issues previously addressed in this guide. The ongoing review, analysis, and monitoring of relevant decision-makers and/or money managers is just as important as the due diligence implemented during the manager selection process.

In keeping with the duty of care, an Investment Steward appointing an Investment Manager must determine the frequency of reviews, taking into account such factors as: (1) prevailing general economic conditions, (2) the size of the portfolio, (3) the investment strategies employed, (4) the investment objectives sought, and (5) the volatility of the investments selected.

The Investment Steward should establish performance expectations for each Investment Manager, and record the same in the IPS. Investment performance should be evaluated in terms of an appropriate market index, and the relevant peer group. By relevant peer group, we mean, for

example, sub-asset class or style, such as large cap value to large cap value, rather than using the S&P 500 or other total market index for every equity position. As a best practice, established “watch list” procedures to be taken when an Investment Manager fails to meet the established due diligence criteria may also be described in the IPS. The IPS should acknowledge that fluctuating rates of return characterize the securities markets, and may cause variations in performance. The Investment Steward should evaluate performance from a long-term perspective.

There often will be times when an Investment Manager is beginning to exhibit shortfalls in the defined performance objectives but, in the opinion of the Investment Steward, does not warrant termination. In such situations, the Steward should establish in the IPS specific “watch list” procedures. The decision to retain or terminate a manager requires judgment and cannot be made by a formula. It is the Steward’s confidence in the Investment Manager’s ability to perform in the future that ultimately determines selection and retention.



## Reasonable Standard

In referring to “reasonable” rebalancing procedures, and other references throughout the guide to a “reasonable” standard of conduct, the legal standard of care is generally one that a reasonably prudent person would observe under a given set of circumstances. An investment fiduciary who subscribes to such a standard, as imprecise as the term may seem, can more likely avoid liability for negligence by following a consistent process.

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## SUBSTANTIATION

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[Employee Retirement Income Security Act of 1974 \[ERISA\]](#)  
§3(38); §402(c)(3); §404(a); §405(c)(2)(A)(iii)

[Case Law](#)

*Leigh v. Engle*, 727 F.2d 113 , 4 E.B.C. 2702(7th Cir. 1984);  
*Atwood v. Burlington Indus. Equity, Inc.*, 18 E.B.C. 2009  
(M.D.N.C. 1994)

[Other](#)

Interpretive Bulletin 75-8, 29 C.F.R.. §2509.75-8 (FR-17);  
Interpretive Bulletin 08-2, 29 C.F.R. §2509.08-2

[Investment Advisers Act of 1940](#)

[Other](#)

Study on Investment Advisers and broker-Dealers (SEC Staff,  
January 21, 2011); Compliance Alert (June, 2007)

[Uniform Prudent Investor Act \[UPIA\]](#)

§2(a); §2(c); §9(a)

[Uniform Prudent Management  
of Institutional Funds Act \[UPMIFA\]](#)

§3(b); §3(e); §5(a)

[Uniform Management of Public](#)

[Employee Retirement Systems Act \[UMPERSA\]](#)

§6(a); §6 (b)(1-3); §6(d); §6 Comments; §8(b)

# PERFORMANCE – RISK-ACCEPTANCE LINEUP

Name	Ticker	Average Period Return (3-yr rolling)	Worst 3-yr rolling	Success Rate (3-yr rolling)	Sharpe Ratio 5 Yr (Qtr-End)
<b>Large Blend Model</b>					
Convergence Core Plus Institutional	MARNX	14.66%	5.48%	100.00%	1.05
Dana Large Cap Equity Institutional	DLCIX	13.67%	6.00%	100.00%	1.10
Schwab US Broad Market ETF™	SCHB	14.25%	8.08%	100.00%	1.23
<b>Large Growth Model</b>					
Nicholas	NICSX	9.93%	-14.15%	79.53%	1.18
Wells Fargo Premier Large Co Gr Inst	EKJYX	9.69%	-9.41%	89.23%	0.80
Schwab US Large-Cap Growth ETF™	SCHG	15.46%	8.48%	100.00%	1.20
<b>Large Value Model</b>					
Madison Dividend Income Y	BHBFX	7.05%	-7.14%	89.76%	1.20
Madison Large Cap Value Y	MYLVX	6.38%	-16.41%	71.65%	1.18
Schwab US Large-Cap Value ETF™	SCHV	13.76%	7.69%	100.00%	1.22
<b>Mid Growth Model</b>					
Baird MidCap Inst	BMDIX	9.10%	-15.10%	81.54%	0.81
Nicholas II I	NCTWX	8.69%	-11.40%	80.77%	1.00
Schwab US Mid-Cap ETF™	SCHM	14.47%	7.04%	100.00%	1.13
<b>Mid Value Model</b>					
Heartland Select Value Investor	HRSVX	8.74%	-13.17%	81.10%	0.88
Wells Fargo Special Mid Cap Value Inst	WFMIX	9.68%	-13.27%	76.85%	1.35
Reinhart Mid Cap PMV Adv	RPMVX	10.04%	-0.12%	97.14%	N/A
Schwab US Mid-Cap ETF™	SCHM	14.47%	7.04%	100.00%	1.13
<b>Small Growth Model</b>					
Broadview Opportunity	BVAOX	9.47%	-13.42%	86.15%	0.78
Nicholas Limited Edition I	NCLEX	9.09%	-12.73%	83.85%	0.85
Vanguard Small-Cap Growth ETF	VBK	2.54%	-40.11%	66.92%	0.86
<b>Small Value Model</b>					
Wells Fargo Special Small Cap Value Inst	ESPNX	7.86%	-17.63%	75.93%	1.05
Vanguard Small-Cap Value ETF	VBR	8.70%	-19.11%	79.20%	1.09

# PERFORMANCE – RISK-ACCEPTANCE LINEUP

Name	Ticker	Average Period Return (3-yr rolling)	Worst 3-yr rolling	Success Rate (3-yr rolling)	Sharpe Ratio 5 Yr (Qtr-End)
<b>Global Equity</b>					
Artisan Global Equity Institutional**	APHHX	13.31%	0.96%	100.00%	0.86
Madison International Stock Y	MINYX	6.35%	-13.11%	69.23%	0.44
Schwab International Equity ETF™	SCHF	5.69%	-1.89%	90.57%	0.47
<b>High Yield Bond Model</b>					
Nicholas High Income I	NCINX	5.73%	-6.45%	93.08%	0.96
Wells Fargo Short-Term Hi Yld Bd Inst	STYIX	4.27%	0.22%	100.00%	1.81
Baird Core Plus Bond Inst	BCOIX	5.78%	1.74%	100.00%	1.08
SPDR® Blmbg Barclays High Yield Bd ETF	JNK	8.08%	-0.96%	94.81%	0.82
<b>Aggregate Bond Model</b>					
Baird Aggregate Bond Inst	BAGIX	5.02%	1.59%	100.00%	1.07
Thompson Bond	THOPX	5.47%	-1.07%	97.69%	1.05
Schwab US Aggregate Bond ETF™	SCHZ	2.55%	1.36%	100.00%	0.72
<b>Alternatives Model</b>					
Plumb Balanced*	PLBBX	6.78%	-6.89%	90.36%	0.94
Madison Covered Call & Equity Income A	MENAX	7.52%	4.13%	100.00%	0.91
RidgeWorth Cap Innvts Gbl Rs&Infrs I	INNNX	-1.04%	-7.53%	42.11%	N/A
Schwab US Large-Cap Growth ETF™	SCHG	15.46%	8.48%	100.00%	1.20

# PERFORMANCE – RISK-MANAGED LINEUP

Name	Ticker	Average Period Return (3-yr rolling)	Worst 3-yr rolling	Success Rate (3-yr rolling)	Std Dev 5 Yr (Qtr-End)	Category Avg 5 Yr Std Dev
<b>Allocation</b>						
Age-Based 18-29***	N/A	9.37%	-3.58%	89.66%	12.53	4.19
Age-Based 30-39***	N/A	10.32%	-4.55%	88.51%	13.93	14.65
Age-Based 40-49***	N/A	9.63%	-4.24%	89.66%	9.18	4.19
Age-Based 50-59***	N/A	8.15%	-0.99%	96.55%	7.08	4.19
Age-Based 60+***	N/A	6.95%	0.56%	100.00%	5.83	7.10

Name	Ticker	Beta 5 Yr (Qtr-End)	R-Squared 5 Yr (Qtr-End)	Alpha 5 Yr (Qtr-End)	Sharpe Ratio 5 Yr (Qtr-End)
<b>Allocation</b>					
Age-Based 18-29***	N/A	0.96	91.97	1.01	1.14
Age-Based 30-39***	N/A	1.03	92.51	1.57	1.20
Age-Based 40-49***	N/A	0.98	93.10	1.20	1.17
Age-Based 50-59***	N/A	0.98	90.17	0.58	1.13
Age-Based 60+***	N/A	1.09	79.78	0.58	1.06

\*\*\*See Managed Model/General Disclosures on pages 35-36

## 4.2 QUALITATIVE MONITOR

Periodic reviews are made of qualitative and/or organizational changes of Investment Advisors, Investment Managers and other service providers.

### CRITERIA

1. Periodic evaluations of the qualitative factors that may impact the results or reliability of Investment Advisors, Investment Managers, and other service providers are performed.
2. Negative news and other material information regarding an Investment Advisor, Investment Manager, or other service provider are considered and acted on in a timely manner.
3. Deliberations and decisions regarding the retention or dismissal of Investment Advisors, Investment Managers, and other service providers are documented.
4. Qualitative factors that may impact service providers are considered in the contract review process.

The Investment Steward has a continuing duty to exercise reasonable care, skill, and caution in monitoring the performance of Investment Managers and the Investment Advisor.

The Investment Steward's review of an Investment Manager must be based on more than recent investment performance results, for all Investment Managers will experience periods of poor performance. Conversely, Stewards also should not be lured into rethinking their manager lineup simply because of the reported success of other managers.

In addition to the quantitative reviews of Investment Managers, periodic reviews of the qualitative performance and/or organizational changes to the Managers should be made at reasonable intervals. On a periodic basis (e.g., quarterly) the Investment Steward should review whether each Investment Manager continues to meet specified objectives using criteria such as the following:

- The Investment Manager's adherence to the guidelines established by the IPS

- Material changes in the Manager's organization, investment philosophy, and/or personnel
- Any legal or regulatory agency proceedings that may affect the Manager

### Materiality Standard

The materiality of an occurrence, event, or information under the law is generally defined as something that is sufficiently significant to influence taking certain actions such as entering into an agreement with an Advisor or deciding whether to take an Advisor's recommendation after disclosure of a conflict of interest. The SEC states "facts are 'material' if a reasonable investor would consider them to be important."

Compensation arrangements, such as those with service providers that may have a significant long-term effect on investment returns, would likely be considered a material factor to be examined by the decision-maker in terms of a reasonable standard. In other words, the Investment Steward should consider whether the costs are reasonable in light of services rendered and in comparison to market rates.

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## SUBSTANTIATION

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Employee Retirement Income Security Act of 1974 [ERISA]  
§3(38); §402(c)(3); §404(a)(1)(b)

**Regulations**

29 C.F.R. §2550.408b-2(d); 29 C.F.R. §2550.408c-2

**Other**

Interpretive bulletin 75-8, 29 C.F.R. §2509.75-8 (FR17);  
booklet: A Look at 401(k) Plan Fees, U.S. Department of Labor,  
Pension and Welfare benefits Administration

Investment Advisers Act of 1940

**Regulations**

17 C.F.R. §275.206(4)-7

**Other**

Compliance Programs of Investment Companies and  
Investment Advisers, SEC Rel. IA-2204 (Dec. 18, 2003)

**Uniform Prudent Investor Act [UPIA]**

§2(a); §7; §9(a)

**Uniform Prudent Management  
of Institutional Funds Act [UPMIFA]**

§3(b); §3(c); §5(a)

**Uniform Management of Public  
Employee Retirement Systems Act [UMPERSA]**

§6(a) and (b)(1-3); §7(5)

# QUALITATIVE METRICS – RISK-ACCEPTANCE LINEUP

Name	Ticker	Manager Tenure (Longest)	Style Consistency Metric (Long)	Fund Size	Fund-Level Net Flow	Morningstar Stewardship Grade
<b>Large Blend Model</b>						
Convergence Core Plus Institutional	MARNX	7.50	25.75	126,886,006	-6.33%	N/A
Dana Large Cap Equity Institutional	DLCIX	7.25	9.92	141,440,043	-29.76%	N/A
Schwab US Broad Market ETF™	SCHB	7.08	1.42	9,042,714,679	10.99%	N/A
<b>Large Growth Model</b>						
Nicholas	NICSX	6.17	20.71	2,845,077,588	-12.71%	N/A
Wells Fargo Premier Large Co Gr Inst	EKJYX	7.08	17.99	2,457,568,960	-33.96%	C
Schwab US Large-Cap Growth ETF™	SCHG	7.08	1.79	4,292,772,702	16.17%	N/A
<b>Large Value Model</b>						
Madison Dividend Income Y	BHBFX	27.33	6.05	104,948,225	-7.64%	N/A
Madison Large Cap Value Y	MYLVX	7.92	23.99	91,818,003	-10.15%	N/A
Schwab US Large-Cap Value ETF™	SCHV	7.08	0.79	3,412,834,170	15.61%	N/A
<b>Mid Growth Model</b>						
Baird MidCap Inst	BMDIX	16.50	7.95	1,463,685,227	2.97%	N/A
Nicholas II I	NCTWX	24.25	6.23	763,914,191	-3.27%	N/A
Schwab US Mid-Cap ETF™	SCHM	6.42	1.73	3,399,344,775	15.64%	N/A
<b>Mid Value Model</b>						
Heartland Select Value Investor	HRSVX	11.08	22.94	243,063,258	-11.35%	N/A
Wells Fargo Special Mid Cap Value Inst	WFMIX	8.42	8.98	6,810,101,150	14.74%	C
Reinhart Mid Cap PMV Adv	RPMVX	5.00	15.61	185,693,074	12.80%	N/A
Schwab US Mid-Cap ETF™	SCHM	6.42	1.73	3,399,344,775	15.64%	N/A
<b>Small Growth Model</b>						
Broadview Opportunity	BVAOX	19.67	12.53	622,091,224	-8.95%	N/A
Nicholas Limited Edition I	NCLEX	24.25	11.62	363,038,637	3.04%	N/A
Vanguard Small-Cap Growth ETF	VBK	12.50	6.50	18,655,438,368	3.71%	N/A

# QUALITATIVE METRICS – RISK-ACCEPTANCE LINEUP

Name	Ticker	Manager Tenure (Longest)	Style Consistency Metric (Long)	Fund Size	Fund-Level Net Flow	Morningstar Stewardship Grade
<b>Small Value Model</b>						
Wells Fargo Special Small Cap Value Inst	ESPNX	15.42	13.24	1,946,256,760	23.24%	C
Vanguard Small-Cap Value ETF	VBR	1.17	4.68	26,847,171,081	8.99%	N/A
<b>Global Equity</b>						
Artisan Global Equity Institutional**	APHHX	7.25	14.16	261,076,119	-2.49%	N/A
Madison International Stock Y	MINYX	19.50	8.24	32,196,772	-11.75%	N/A
Schwab International Equity ETF™	SCHF	4.50	1.30	9,853,358,415	21.85%	N/A
<b>High Yield Bond Model</b>						
Nicholas High Income I	NCINX	14.17	N/A	107,912,679	-2.53%	N/A
Wells Fargo Short-Term Hi Yld Bd Inst	STYIX	19.08	N/A	1,487,431,564	2.86%	C
Baird Core Plus Bond Inst	BCOIX	16.75	N/A	14,150,285,898	7.39%	N/A
SPDR® Blmbg Barclays High Yield Bd ETF	JNK	9.58	3.76	11,801,730,902	0.15%	N/A
<b>Aggregate Bond Model</b>						
Baird Aggregate Bond Inst	BAGIX	16.75	N/A	12,305,424,954	13.41%	N/A
Thompson Bond	THOPX	25.33	N/A	2,543,888,858	17.09%	N/A
Schwab US Aggregate Bond ETF™	SCHZ	5.92	N/A	3,753,097,993	12.40%	N/A
<b>Alternatives Model</b>						
Plumb Balanced*	PLBBX	10.08	10.29	34,805,790	-7.17%	N/A
Madison Covered Call & Equity Income A	MENAX	7.67	22.72	111,607,783	3.85%	N/A
RidgeWorth Cap Innvts Gbl Rs&Infrs I	INNNX	4.75	9.69	8,561,906	40.23%	N/A
Schwab US Large-Cap Growth ETF™	SCHG	7.08	1.79	4,292,772,702	16.17%	N/A



# QUALITATIVE METRICS – RISK-MANAGED LINEUP

Name	Ticker	Inception Date	Manager Tenure (Average)	% Proprietary Assets
<b>Allocation</b>				
Age-Based 18-29***	N/A	12/31/2003	17.39	0.00%
Age-Based 30-39***	N/A	12/31/2003	16.94	0.00%
Age-Based 40-49***	N/A	12/31/2003	16.94	0.00%
Age-Based 50-59***	N/A	12/31/2003	16.87	0.00%
Age-Based 60+***	N/A	12/31/2003	15.83	0.00%

\*\*\*See Managed Model/General Disclosures on pages 35-36

## 4.3 EXECUTION MONITOR

Control procedures are in place to periodically review policies for trading practices and proxy voting.

### CRITERIA

1. Control procedures are in place to periodically review each Investment Manager's policies for best execution.
2. Control procedures are in place to periodically review each Investment Manager's policies for special trading practices such as "soft dollars", directed brokerage, and commission recapture.
3. Control procedures are in place to periodically review each Investment Manager's policies for proxy voting.

The Investment Steward has a responsibility to control and account for investment expenses and to assess whether the expenses incurred are consistent with the fiduciary obligation to serve the best interests of the participant or beneficiary. Monitoring and controlling expenses is consistent with a fiduciary duty of care and even more so when an Investment Manager applies an active trading strategy, uses directed brokerage or soft dollars, and other expenses that, over time, can significantly impair portfolio performance. Even seemingly minor, but recurring expenses need to be documented and justified.

Similarly, the Investment Steward should ensure that the plan or trust has an established policy in place for proxy voting, consistent with the duties of loyalty and care. Proxies should be voted in a manner that preserves or enhances the value of the security. The proxy policy and responsibility for who is to vote proxies should be in the IPS, especially for ERISA plans. Responsibility for voting proxies normally rests with the Steward or is delegated by the Steward to Investment Managers.

The Investment Steward also needs to monitor trading policies and procedures that ensure:

- Best execution policies are applied in securities transactions. The Investment Steward has a responsibility to seek confirmation that each Investment Manager is seeking best execution in trading the portfolio's securities. In seeking best execution, Investment Managers are required to shop their trades with various brokerage firms, taking into consideration: (1) commission costs, (2) an analysis of the actual execution price of the security, and (3) the quality and reliability (timing) of the trade.
- "Soft dollars" are expended only for brokerage and research for the benefit of the investment program, and the amount must be reasonable in relation to the value of such services. Soft dollars represent the excess in commission costs: the difference between what a brokerage firm charges for a trade versus the brokerage firm's actual costs. The failure of the Investment Steward to monitor soft dollars may subject the investment program to expenditures that yield insufficient investor benefit to justify the cost, itself a fiduciary breach.

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## SUBSTANTIATION

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### Employee Retirement Income Security Act of 1974 [ERISA]

§3(38); §402(c)(3); §403(a)(1) and (2); §404(a)(1)(A) and (b)

#### Case Law

*Herman v. NationsBank Trust Co.*, (Georgia), 126 F.3d 1354, 21 E.B.C. 2061 (11th Cir. 1997), *reh'g denied*, 135 F.3d 1409 (11<sup>th</sup> Cir.), *cert. denied*, 525 U.S. 816, 19 S.Ct. 54, 142 L.ed.2d 42 (1998)

#### Other

Interpretive bulletin 75-8, 29 C.F.R. §2509.75-8 (FR-17Q); Interpretive bulletin 08-2, 29 C.F.R. §2509.08-2; DOL Prohibited Transaction exemption 75-1, Interim exemption, 40 Fed. Reg. 5201 (Feb. 4, 1975); DoL Information Letter, Prescott Asset Management (1/17/92) (fn. 1); DOL Information Letter, Refco, Inc. (2/13/89); ERISA Technical Release 86-1 (May 22, 1986)

### Investment Advisers Act of 1940

§206(4); Securities exchange Act of 1934 §28(e)

#### Regulation

17 C.F.R. §275.206(4)-6; 17 C.F.R. §275.206(4)-7

#### Case Law

*In re Arleen W. Hughes*, Act Rel. no. 4073, (Feb. 20, 1948)

#### Other

Securities exchange Act Rel. no. 23170 (Apr. 23, 1986); IAA Rel. no. 232 (Oct. 16, 1968); *Charles Lerner, Esq.*, SEC no-Action Letter (July 25, 1990); IAA Rel. no. 2106 (Jan. 31, 2003); Investment Company Act Rel. no. 25922 (Jan. 31, 2003); *Salomon Bros.*, SEC no-Action Letter (May 23, 1972)

### Uniform Prudent Investor Act [UPIA]

§2(a) and (d); §7; §9(a)

### Uniform Prudent Management of Institutional Funds Act [UPMIFA]

§3(b), (c), and (e)(5); §5(a)

### Uniform Management of Public Employee Retirement Systems Act [UMPERSA]

§6(2) and (3); § 7(2), (3), and (5); §8(a)(3)

## 4.4 EXPENSE MONITOR

Periodic reviews are conducted to ensure that investment-related fees, compensation, and expenses are fair and reasonable for the services provided.

### CRITERIA

1. A summary of all parties being compensated from the portfolio or from plan or trust assets and the amount of compensation has been documented.
2. Fees, compensation, and expenses paid from the portfolio or from plan or trust assets are periodically reviewed to ensure consistency with all applicable laws, regulations, and service agreements.
3. Fees, compensation, and expenses paid from plan or trust assets are periodically reviewed to ensure such costs are fair and reasonable based upon the services rendered and the size and complexity of the portfolio or plan.

The Investment Steward has a duty to account for all dollars spent on investment management services, whether those dollars are paid directly from the account or in the form of soft dollars and other fee-sharing arrangements. In addition, the Steward has the responsibility to identify those parties that have been compensated from the fees, and to apply a reasonableness test to the amount of compensation received by any party.

In the case of an all-inclusive fee (sometimes referred to as a “bundled” or “wrap” fee) investment product, the Investment Steward should investigate how the various service vendors associated with each component of the all-inclusive fee are compensated to ensure that no one vendor is receiving unreasonable compensation, and to compare the costs of the same services on an à la carte basis.

In the case of defined contribution plans, it is customary to offer investment options that carry fees that often are used to offset the plan’s record-keeping and administrative costs. Particularly for a new plan with few assets, such an arrangement can be beneficial for the participants.

Investment Stewards should not, however, use the availability of revenue sharing that can offset any administrative plan expenses as a critical factor in making investment selections. The Investment Steward should periodically determine whether it is more advantageous to pay for record-keeping and administrative costs on an à la carte basis using funds that forego revenue sharing and have lower expense ratios.

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## SUBSTANTIATION

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Employee Retirement Income Security Act of 1974 [ERISA]  
§3(14)(b); §404(a)(1)(A), (b) and (D); §406(a); §408(b)(2)

### Regulations

29 C.F.R. §2550.408(b)(2)

### Case Law

*Brock v. Robbins*, 830 F.2d 640, 8 E.B.C. 2489 (7th Cir. 1987)

### Other

Booklet: A Look at 401(k) Plan Fees, U.S. Department of Labor, Pension and Welfare benefits Administration; DOL Advisory opinion Letter 2001-01A (1/18/01); DOL Advisory opinion Letter (7/28/98) 1998 WL 1638072; DOL Advisory opinion Letter 89-28A (9/25/89) 1989 WL 435076; Interpretive bulletin 75-8, 29 C.F. R. §2509.75-8 (FR-17Q); California Assembly bill no.1743 (Chapter 668, Statutes of 2010), codified in scattered sections of the California Government Code; 11 CRR-NY 136-2.4(d); DOL Advisory opinion 97-15A (May 22, 1997); DOL Advisory opinion 97-16A (May 22, 1997)

Investment Advisers Act of 1940

§205(a)(1)

### Regulations

17 C.F.R. §275.205-3; 17 C.F.R. § 275.206(4)-3

### Case Law

*SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963)

### Other

*Bisys Fund Servs., Inc.*, SEC no-Action Letter (Sept. 2, 1999); SEC Investment Adviser examination Manual (1980); Compliance Programs of Investment Companies and Investment Advisers, SEC Rel. no. IA-2017 (Feb. 5, 2003); *Don P. Matheson & Co.*, SEC no-Action Letter (May 15, 1976)

### State Securities Regulations

SNASAA Unethical business Practices of Investment Advisers, Investment Adviser Representatives, And Federal Covered Advisers, Model Rule 102(a)(4)-1 *Adopted 4/27/97, amended 4/18/04, 9/11/05* <http://www.nasaa.org/content/Files/IAUnethical091105.pdf> (August 2011)

SNASAA Investment Adviser Representative Definition, Model rule USA 2002 102(16), adopted by NASAA on Sept. 17, 2008, [http://www.nasaa.org/content/Files/IA\\_Model\\_Rules\\_Under\\_2002%20Act\\_091708.pdf](http://www.nasaa.org/content/Files/IA_Model_Rules_Under_2002%20Act_091708.pdf) (August 2011)

Uniform Prudent Investor Act [UPIA]

§2(a); §7 and Comments; §9, Comments

### Case Law

Matter of Derek W. Bryant, 188 Misc. 2d 462, 729 NYS 2d 309 (6/21/01)

### Other

McKinneys EPTL11-2.3(d)

Uniform Prudent Management  
of Institutional Funds Act [UPMIFA]  
§3(a), (b), and (c); §5(a) and (c)(1)

Uniform Management of Public  
Employee Retirement Systems Act [UMPERSA]  
§6(b)(2) and (3); §7(2) and (5); §7, Comments

# EXPENSES

## RISK-ACCEPTANCE LINEUP

Name	Ticker	Prospectus Net Expense Ratio	Morningstar Fees Grade	Morningstar Fee Level % Rank - Broad	Category Prospectus Net Expense Ratio
<b>Large Blend Model</b>					
Convergence Core Plus Institutional	MARNX	1.31%	N/A	75	1.07%
Dana Large Cap Equity Institutional	DLCIX	0.73%	N/A	28	1.07%
Schwab US Broad Market ETF™	SCHB	0.03%	N/A	1	1.07%
<b>Large Growth Model</b>					
Nicholas	NICSX	0.72%	N/A	27	1.15%
Wells Fargo Premier Large Co Gr Inst	EKJYX	0.70%	C	25	1.15%
Schwab US Large-Cap Growth ETF™	SCHG	0.04%	N/A	1	1.15%
<b>Large Value Model</b>					
Madison Dividend Income Y	BHBFX	0.95%	N/A	48	1.07%
Madison Large Cap Value Y	MYLVX	0.91%	N/A	45	1.07%
Schwab US Large-Cap Value ETF™	SCHV	0.04%	N/A	1	1.07%
<b>Mid Growth Model</b>					
Baird MidCap Inst	BMDIX	0.83%	N/A	23	1.25%
Nicholas II I	NCTWX	0.61%	N/A	11	1.25%
Schwab US Mid-Cap ETF™	SCHM	0.05%	N/A	1	1.25%
<b>Mid Value Model</b>					
Heartland Select Value Investor	HRSVX	1.23%	N/A	59	1.18%
Wells Fargo Special Mid Cap Value Inst	WFMIX	0.87%	C	28	1.18%
Reinhart Mid Cap PMV Adv	RPMVX	1.11%	N/A	52	1.18%
Schwab US Mid-Cap ETF™	SCHM	0.05%	N/A	1	1.18%
<b>Small Growth Model</b>					
Broadview Opportunity	BVAOX	1.27%	N/A	60	1.21%
Nicholas Limited Edition I	NCLEX	0.86%	N/A	18	1.31%
Vanguard Small-Cap Growth ETF	VBK	0.07%	N/A	1	1.31%

# EXPENSES

## RISK-ACCEPTANCE LINEUP

Name	Ticker	Prospectus Net Expense Ratio	Morningstar Fees Grade	Morningstar Fee Level % Rank - Broad	Category Prospectus Net Expense Ratio
<b>Small Value Model</b>					
Wells Fargo Special Small Cap Value Inst	ESPNX	0.95%	C	26	1.33%
Vanguard Small-Cap Value ETF	VBR	0.07%	N/A	1	1.33%
<b>Global Equity</b>					
Artisan Global Equity Institutional**	APHHX	1.13%	N/A	45	1.30%
Madison International Stock Y	MINYX	1.35%	N/A	70	1.12%
Schwab International Equity ETF™	SCHF	0.06%	N/A	1	1.12%
<b>High Yield Bond Model</b>					
Nicholas High Income I	NCINX	0.69%	N/A	24	1.08%
Wells Fargo Short-Term Hi Yld Bd Inst	STYIX	0.51%	C	6	1.08%
Baird Core Plus Bond Inst	BCOIX	0.30%	N/A	8	0.79%
SPDR® Blmbg Barclays High Yield Bd ETF	JNK	0.40%	N/A	3	1.08%
<b>Aggregate Bond Model</b>					
Baird Aggregate Bond Inst	BAGIX	0.30%	N/A	8	0.79%
Thompson Bond	THOPX	0.72%	N/A	55	0.80%
Schwab US Aggregate Bond ETF™	SCHZ	0.04%	N/A	2	0.79%
<b>Alternatives Model</b>					
Plumb Balanced*	PLBBX	1.30%	N/A	66	1.19%
Madison Covered Call & Equity Income A	MENAX	1.28%	N/A	24	1.55%
RidgeWorth Cap Innvts Gbl Rs&Infrs I	INNNX	1.15%	N/A	51	1.41%
Schwab US Large-Cap Growth ETF™	SCHG	0.04%	N/A	1	1.15%

# EXPENSES

## RISK-MANAGED LINEUP

Name	Ticker	Prospectus Net Expense Ratio	Category Prospectus Net Expense Ratio
<b>Allocation</b>			
Age-Based 18-29***	N/A	0.07%	0.89%
Age-Based 30-39***	N/A	0.09%	1.48%
Age-Based 40-49***	N/A	0.08%	0.89%
Age-Based 50-59***	N/A	0.08%	0.89%
Age-Based 60+***	N/A	0.07%	1.19%

\*\*\*See Managed Model/General Disclosures on pages 35-36



## 4.5 FIDUCIARY MONITOR

There is a process to periodically review the Steward's effectiveness in meeting its fiduciary responsibilities.

### CRITERIA

1. Fiduciary assessments are conducted at planned intervals to determine whether
  - (a) appropriate policies and procedures are in place to address all fiduciary obligations,
  - (b) such policies and procedures are effectively implemented and maintained, and
  - (c) the investment policy statement is reviewed at least annually.
2. Fiduciary assessments are conducted in a manner that promotes objective analysis and results are documented and reviewed for reasonableness.

Fiduciary duties generally are presented as distinct obligations substantiated through law and regulation. Many of the duties are accompanied by documentation and review obligations. As a practical matter, a comprehensive framework is needed to ensure that all applicable fiduciary practices are fully and effectively addressed on an ongoing basis. A planned approach to conduct periodic reviews provides such a framework.

Under the Pension Protection Act of 2006 (PPA), the practices of plan sponsors and fiduciary advisers who are party to eligible investment advice arrangements (EIAAs) must be examined as part of the required

annual independent audit of the EIAA. Given that internal and external reviews and assessments are well-recognized tools to evaluate risks and ensure the effectiveness of policies and procedures, further weight is added to the need to establish a formal overall review process (as provided by an assessment program).

Finally, it is important to recognize that the trend in law and regulation is towards greater formality in: (1) policies and procedures and (2) processes that ensure that the policies and procedures are effective.

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## SUBSTANTIATION

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### Employee Retirement Income Security Act of 1974 [ERISA] §404(a)(1)(b)

#### Case Law

*Fink v. National Savings & Trust Co.*, 772 F.2d 951, 957 (D.C. Cir. 1985); *Liss v. Smith*, 991 F.Supp. 278, 299-300 (S.D.N.Y., 1998); *Harley v. Minnesota Mining and Manufacturing Company*, 42 F.Supp. 2d 898, 906 (D. Minn. 1999)

#### Other

Department of Labor employee benefits Security Administration, "Meeting your Fiduciary Responsibilities" (May 2004); 29 C.F.R. 2509.75-8; 29 C.F.R. 2509.08-2; 17 C.F.R. § 275.206(4)-7; DOL Field Assistance bulletin 2007-01.

### Investment Advisers Act of 1940

#### Regulation

17 C.F.R. §275.206(4)-7)

### Uniform Prudent Investor Act [UPIA]

§2(a); §2(d)

### Uniform Prudent Management of Institutional Funds Act [UPMIFA]

§3(b) and (c)

### Uniform Management of Public Employee Retirement Systems Act [UMPERSA]

§8(b); §7

The approach used to structure the Practices in this guide is modeled after that used by the International Organization for Standardization (ISO). Recently, the financial services community has begun to recognize the value of certification of conformity to standards. There is now an ISO standard for financial planning (ISO 22222) and investment performance reporting practices can be certified to Global Investment Performance Standards (GIPS). In 2006, the Centre for Fiduciary Excellence (CEFEX) was formed to certify conformity with the practices covered in the Prudent Practices for Investment Fiduciaries handbook series. fi360 is a founding member of CEFEX.

# CONCLUSION

The Practices identified in this guide prescribe a process that strives for excellence in the management of investment decisions. The Practices will help fiduciaries understand which new investment strategies, products, and techniques fit into their operations, and which do not.

The intelligent and prudent management of investment decisions requires the fiduciary to maintain a rational, disciplined investment program. The mind-boggling array of investment choices, coupled with market noise from stock markets around the world, understandably can result in financial paralysis from information overload. Fiduciaries clearly need a framework for managing investment decisions that allows them to consider developing investment trends, and to thoughtfully navigate the possibilities.

# MANAGED MODEL DISCLOSURES

1. This report has been generated with information provided by a third party. Information obtained from third party sources are believed to be reliable but are not guaranteed. Performance, expenses and other portfolio statistics are calculated based on the performance and statistics of the underlying investments weighted based on the target allocation as listed. The performance is not representative of performance of any specific portfolio. Expenses of the underlying investments are included in the performance figures as calculated including model fee of 0.035%. Additional portfolio management and service fees are not included in the performance numbers presented. Past performance is not an indication of future performance, and the underlying mutual fund values will fluctuate with changes in market conditions. Your investment may be worth more or less than your original cost when you redeem your shares. Read the prospectus carefully before you invest in any mutual fund. It contains information on a fund's investment strategies, risks, expenses and fees.

2. Fund share prices will fluctuate and are priced daily. The value of your principal investment will fluctuate accordingly and may be worth more or less than your original investment. As with any investment there are risks associated with investments in mutual funds and the risks will vary for every fund. You should invest in mutual funds or portfolios that meet your investment objectives. Management fees charged by the mutual fund company will vary for every fund and these charges may affect the performance of the fund. Current performance may be higher or lower than data shown. Diversification in a portfolio does not guarantee a profit or guarantee protection against losses.

3. The model portfolio shows the hypothetical value of the combined performance returns ("Model Portfolio Returns") for each investment strategy or product included in this proposal for the time periods indicated. These Model Portfolios Returns do not reflect the actual investment results of any client portfolio, but represent the hypothetical performance of this proposal, which is calculated by weighting the performance of each investment strategy or product included in this proposal at the allocation percentages detailed in this proposal. This allocation percentage of each investment strategy or product included in this proposal is fixed for the time periods indicated for the Model Portfolio Returns.

4. Model results have certain inherent limitations, particularly that such results do not represent actual trading and that they may not reflect the impact that material economic and market factors might have had on the asset manager's decision making if the asset manager were actually managing clients' money. Performance results for clients invested pursuant to this proposal will vary due to market conditions and other factors, including cash flows, fund allocations, frequency and precision of rebalancing, cash balances, varying custodial fees, and the timing of fee deductions. As a result, actual performance for client accounts may differ materially from, and may be lower than, that of a model portfolio.

5. The performance results of the underlying investment strategies or products in the Model Portfolio Returns assume the reinvestment of dividends and other earnings. Model Portfolio Returns represent past performance and are not indicative of any specific investment. The model portfolio's current performance may be lower or higher than the performance data quoted as it represents past performance. An investment pursuant to this portfolio is subject to market risk and an investor may experience loss of principal. The information is based on data received from the investment strategy manager and/or other sources, such as reporting service providers, but has not been independently verified.

6. The Model Portfolio Returns are compared to a selected benchmark, indicated in each chart. The reported benchmarks are not intended as direct comparisons to the performance of the portfolio. Instead, they are intended to represent the performance of certain sectors of the overall securities market (e.g. equities, bonds, etc), so that an investor may compare the effects of material market or economic conditions on the results portrayed (e.g. the Model Portfolio Returns may show a 5% investment appreciation, but those sectors of the overall securities market appreciated 7% over the same time period). Respectively, the volatility and performance of the reported benchmark may be greater than or less than the volatility and performance of the investment portfolio. The Model Weighted Average Net Expense Ratio applies only to the portion of the model that is comprised of mutual funds and/or ETFs. It reflects expense waivers or reimbursements from the fund companies, which may not be permanent. The data used to calculate the Model Weighted Average Net Expense Ratio is obtained from a third-party data provider and is believed to be accurate, but has not been verified. The Model Weighted Average Net Expense Ratio will only be shown if fund expense ratios are available on all mutual funds and ETFs used in the model.

# MANAGED MODEL & GENERAL DISCLOSURES

7. All models are managed by Appleton Group LLC which derives no additional compensation above their stated fiduciary fee. Model portfolios may be adjusted at the discretion of Appleton Group LLC without prior notice to you. Although Appleton Group LLC carefully evaluates the makeup of the portfolios on a regular basis, we make no representation regarding the likelihood or probability that any or all of the portfolios will in fact achieve a particular investment goal or fulfill the risk tolerance profile as described for each portfolio. As a self-directed investor, you should carefully consider the merit and appropriateness of the available investments under your employer's retirement plan in light of your own personal financial circumstances, including your other assets, income, investments, and/or cash flow needs.

## General Disclosures:

The investment's performance may be impacted by its concentration in a certain type of security, adherence to a particular investing strategy or unique aspect of its structure and costs.

The Appleton Group Portfolios are not mutual funds. As market conditions fluctuate, the investment return and principal value of any investment will change. Before investing in any investment portfolio, the client and financial advisor should carefully consider the client's investment objective, time horizon, risk tolerance, and fees. Diversification may not protect against market risk. There are risks involved with investing, including possible loss of principal. Appleton Group LLC utilizes ETFs as the primary underlying investment vehicle. Since each Age-Based Model is a "portfolio of funds" an investor will indirectly bear fees and expenses charged by the underlying ETFs and investment companies in which Appleton Group LLC invests.

The cumulative effect of fees and expenses can substantially reduce the growth of your retirement savings. Visit the Department of Labor's Website for an example showing the long-term effect of fees and expenses at [http://www.dol.gov/ebsa/publications/401k\\_employee.html](http://www.dol.gov/ebsa/publications/401k_employee.html). Fees and expenses are only one of the many factors to consider when you decide to invest in an option. Please consider whether an investment in a particular managed strategy, along with your other investments, will help you achieve your financial goals.

# GLOSSARY

This glossary was compiled from the following sources:

Eugene b. Burroughs, CFA, *Investment Terminology* (revised edition), International Foundation of employee benefit Plans, Inc., 1993.

John Downes and Jordan Elliot Goodman, *Dictionary of Finance and Investment Terms* (Fifth edition), Barron's Educational Series, Inc., 1998.

John W. Guy, *How to Invest Someone Else's Money*, Irwin Professional Publishing, Burr Ridge, Illinois, 1994.

Joshua P. Itzoe, CFP®, AIF®, *Fixing the 401(k), What Fiduciaries Must Know (And Do) To Help Employees Retire Successfully*, Mill City Press, Minneapolis, MN, 2008.

Ken Ziesenheim, CFP®, JD, LL.M., *Understanding ERISA*, Ken Ziesenheim and Marketplace Books, 2002.

Morningstar®. Morningstar Investment Glossary. 2014.

**Accredited Investment Fiduciary® (AIF®)** – Professional designation signifying knowledge and competency in fiduciary responsibility.

**Accredited Investment Fiduciary Analyst® (AIFA®)** – Professional designation for those who wish to conduct ISO-like assessments of a global fiduciary standard of excellence.

**alpha** – Statistic that measures a portfolio's return in excess of the market return adjusted for risk. It is a measure of the Manager's contribution to performance with reference to security selection. A positive alpha indicates that a portfolio was positively rewarded for the residual risk, which was taken for that level of market exposure.

**assessment** – The process of determining whether a fiduciary conforms with defined Practices and Criteria.

**asset allocation** – The process of determining the optimal allocation of a fund's portfolio among broad asset classes in order to increase expected risk-adjusted return.

**basis point** – one hundredth of a percent (100 basis Points = 1%). basis points are often used to express changes or differences in yields, returns or interest rates.

**best execution** – Formally defined as the difference between the execution price (the price at which a security is actually bought or sold) and the "fair market price," which involves calculating opportunity costs by examining the security price immediately after the trade is placed. Best execution occurs when the trade involves no lost opportunity cost; for example, when there is no increase in the price of a security shortly after it is sold.

**Beta** – A measure of a fund's sensitivity to market movements. The beta of the market is 1.00 by definition.

**cash sweep accounts** – A money market fund or cash account into which all new contributions, stock dividend income, and bond interest income is placed ("swept") for a certain period of time. At regular intervals, or when rebalancing is necessary, this cash is invested in assets in line with the asset allocation stipulated in the IPS.

**CEFEX®, Centre for Fiduciary Excellence** – An independent global assessment and certification organization. CEFEX works closely with investment fiduciaries and industry experts to provide comprehensive assessment programs to improve risk management for institutional and retail investors. CEFEX certification helps determine trustworthiness of investment fiduciaries.

**CEFEX Analyst** – A person approved by CEFEX to conduct an assessment of a firm's fiduciary practices for CEFEX Certification.

**CEFEX Certification** – Independent recognition of a firm's conformity to Practices and Criteria within the Standard of excellence. It implies that a firm can demonstrate adherence to the industry's best practices, and is positioned to earn the public's trust.

**commingled fund** – An investment fund, similar to a mutual fund, in which investors purchase and redeem units that represent ownership in a pool of securities. Commingled funds usually are offered through a bank-administered plan allowing for lower cost, diversification, and professional money management.

**commission recapture** – An agreement by which a retirement plan fiduciary earns credits based upon the amount of brokerage commissions paid. These credits can be used for services that will benefit a retirement plan, such as consulting services, custodian fees, or hardware and software expenses.

**correlation coefficient** – Correlation measures the degree to which two variables are associated. Correlation is a commonly used tool for constructing a well-diversified portfolio. Traditionally, equities and fixed income asset returns have not moved closely together. The asset returns are not strongly correlated. A balanced fund with equities and fixed income assets represents a diversified portfolio that attempts to take advantage of the low correlation between the two asset classes.

**Criteria** – Define the scope and details of a Practice and provide a standard by which a Practice can be evaluated.

**directed brokerage** – Circumstances in which a board of trustees or other fiduciary requests that the Investment Manager direct trades to a particular broker so that the commissions generated can be used for specific services and/or resources. See soft dollars.

**economically targeted investment (ETI)** – Investments where the goal is to target a certain economic activity, sector, or area in order to produce corollary benefits in addition to the main objective of earning a competitive risk adjusted rate of return.

**expected return** – The expected value or mean of all the likely returns of investments comprising a portfolio. Expected return is the sum of each possible return, multiplied by its respective probability or risk.

**fi360** – An organization that promotes a culture of investment fiduciary responsibility and improves the decision making processes of investment fiduciaries.

**fiduciary** – From the Latin word fiducia, meaning “trust.” Someone who stands in a special relation of trust, confidence, and/or legal responsibility. A fiduciary is held to a standard of conduct and trust above that of a stranger or of a casual business person due to the superior knowledge and/or training of the fiduciary.

**fiduciary excellence** – A function of how well Investment Stewards, Investment Advisors, and Investment Managers follow defined fiduciary Practices and Criteria.

**fund-level net flow** – The net of all cash inflows and outflows in and out of a fund. The performance of the fund is not taken into account.

**Investment Advisor** – A professional who is responsible for providing investment advice and/or managing investment decisions. Investment Advisors include wealth managers, financial advisors, trust officers, financial consultants, investment consultants, financial planners, and fiduciary advisers. See registered Investment Adviser.

**Investment Manager** – A professional who has discretion to select specific securities for separate accounts, mutual funds and exchange traded funds commingled trusts, and unit trusts.

note: An ERISA §3(38) Investment Manager is any fiduciary (other than a trustee or named fiduciary) who has the power to manage, acquire, or dispose of plan assets; is either a registered investment adviser under the Investment Advisers Act of 1940, a bank or an insurance company; and has acknowledged its fiduciary status in writing to the plan.

**Investment Steward** – A person who has the legal responsibility for managing investment decisions on behalf of others, including plan sponsors, trustees, and investment committee members.

**liquidity** – The ease with which assets can be converted into cash with little risk of loss of principal. Any asset other than cash has some liquidity risk, though money market funds and the instruments that they typically hold are generally considered adequately liquid to meet short term spending requirements without exposing a portfolio to undue risk of loss.

**liquidity risk** – The risk stemming from the lack of marketability of an investment that cannot be bought or sold quickly enough to prevent or minimize a loss

**maximum drawdown** – The worst return an investor could have achieved in one completed trade with a given investment. It is a measure of the greatest peak to trough decline since the inception of the security.

**Morningstar Risk Rating** – An annualized measure of a fund’s downside volatility. In each Morningstar Category:

- top 10% of investments - High
- next 22.5% - Above Average
- middle 35% - Average
- next 22.5% - Below Average
- bottom 10% - Low

**Morningstar Stewardship Grade** – An evaluative data point in Morningstar’s fund and stock reports that assesses the quality of a company’s governance practices. Stewardship grades for both funds and stocks range from ‘A’ (excellent) to ‘F’ (very poor) based on criteria that measures the effectiveness of fund and corporate managers to consistently act with their shareholders’ best interests in mind.

**Practice** – The details of a prudent process that provide the foundation and framework for a disciplined investment process.

**proxy voting** – A written authorization given by a shareholder to someone else to vote his or her shares at a stockholders’ annual or special meeting called to elect directors or for some other corporate purpose.

**risk-acceptance fund** – Funds that are mandated to execute a certain fund style. These funds do not diversify across asset classes nor make adjustments to asset allocations in response to changing market conditions.

**risk-adjusted return** – The return on an asset, or portfolio, modified to explicitly account for the risk of the asset or portfolio.

**risk-free rate of return** – The return on 90-day U.S. Treasury bills. This is used as a proxy for no risk due to its zero default risk issuance, minimal “interest rate” risk and high marketability. The term is really a misnomer since nothing is free of risk. It is utilized since certain economic models require a “risk free” point of departure. See Sharpe Ratio.

**risk-managed fund** – Funds that work to reduce the risk of large losses by diversifying across asset classes and/or making adjustments to asset allocations as market conditions change.

# GLOSSARY

**risk tolerance** – The degree to which an investor is comfortable with the potential of losing money without abandoning a defined investment strategy.

**Rolling Returns** – Rolling returns display returns in overlapping cycles starting on the first day of the month for period displayed. Rolling returns are useful for examining the behavior of returns for holding periods similar to those actually experienced by investors. The goal is to show you the frequency and magnitude of an investment's good and bad performance periods. Success Rate identifies the percentage of rolling periods which produced positive returns of any magnitude.

**R-squared (R<sup>2</sup> or R2)** – Formally called the coefficient of determination, this measures the overall strength or “explanatory power” of a statistical relationship. In general, a higher R2 means a stronger statistical relationship between the variables that have been estimated, and therefore more confidence in using the estimation for decision making. Primarily used to determine the appropriateness of a given index in evaluating an Investment Manager's performance.

**safe harbor** – A legal or regulatory provision that may limit a fiduciary's liabilities as long as certain guidelines are fully adhered to.

**self-dealing** – Self-dealing exists when either (or both) of the following criteria are met: 1) the underlying sub-accounts are proprietary; 2) the advisor and/or vendor receive additional compensation (hidden or disclosed) from the underlying sub-accounts.

**Sharpe Ratio** – This statistic is a commonly used measure of risk-adjusted return. It is calculated by subtracting the risk free rate of return (usually 3-Month U.S. Treasury bill) from the portfolio return and dividing the resulting “excess return” by the portfolio's total risk level (standard deviation). The result is a measure of return gained per unit of total risk taken. The Sharpe ratio can be used to compare the relative performance of managers. If two managers have the same level of risk but different levels of excess return, the manager with the higher Sharpe ratio would be preferable.

**socially responsible investment (SRI)** – An investment that is undertaken based upon social, rather than purely financial, guidelines. See also economically targeted investment.

**soft dollars** – The payment for brokerage services through commission revenue rather than direct payments. For example, a portion of a commission expense may be used to pay for research or other services in excess of the actual cost of executing the trade provided by the broker dealer.

**Standard of Excellence** – The Practices and Criteria that detail a prudent process and the attributes of a trustworthy fiduciary.

**standard deviation** – A statistical measure of portfolio risk. It reflects the average deviation of the observations from their sample mean. Standard deviation is used as an estimate of risk since it measures

how wide the range of returns typically is. The wider the typical range of returns, the higher the standard deviation of returns, and the higher the portfolio risk. If returns were normally distributed (i.e., has a bell shaped curve distribution) then approximately two thirds of the returns would occur within plus or minus one standard deviation from the sample mean

**strategic asset allocation** – Rebalancing back to the normal mix at specified time intervals (quarterly) or when established risk tolerance levels are violated.

**style consistency metric** – A measure of historical portfolio/strategy movement in both the value-growth and size dimensions. Style consistency is derived as follows:

- <9 – High consistency
- 9-29 – Medium consistency
- >29 – Low consistency

**tactical asset allocation** – The “first cousin” to Market Timing which involves the use of certain “indicators” to make adjustments in the proportions of portfolio invested in three asset classes – stocks, bonds, and cash.

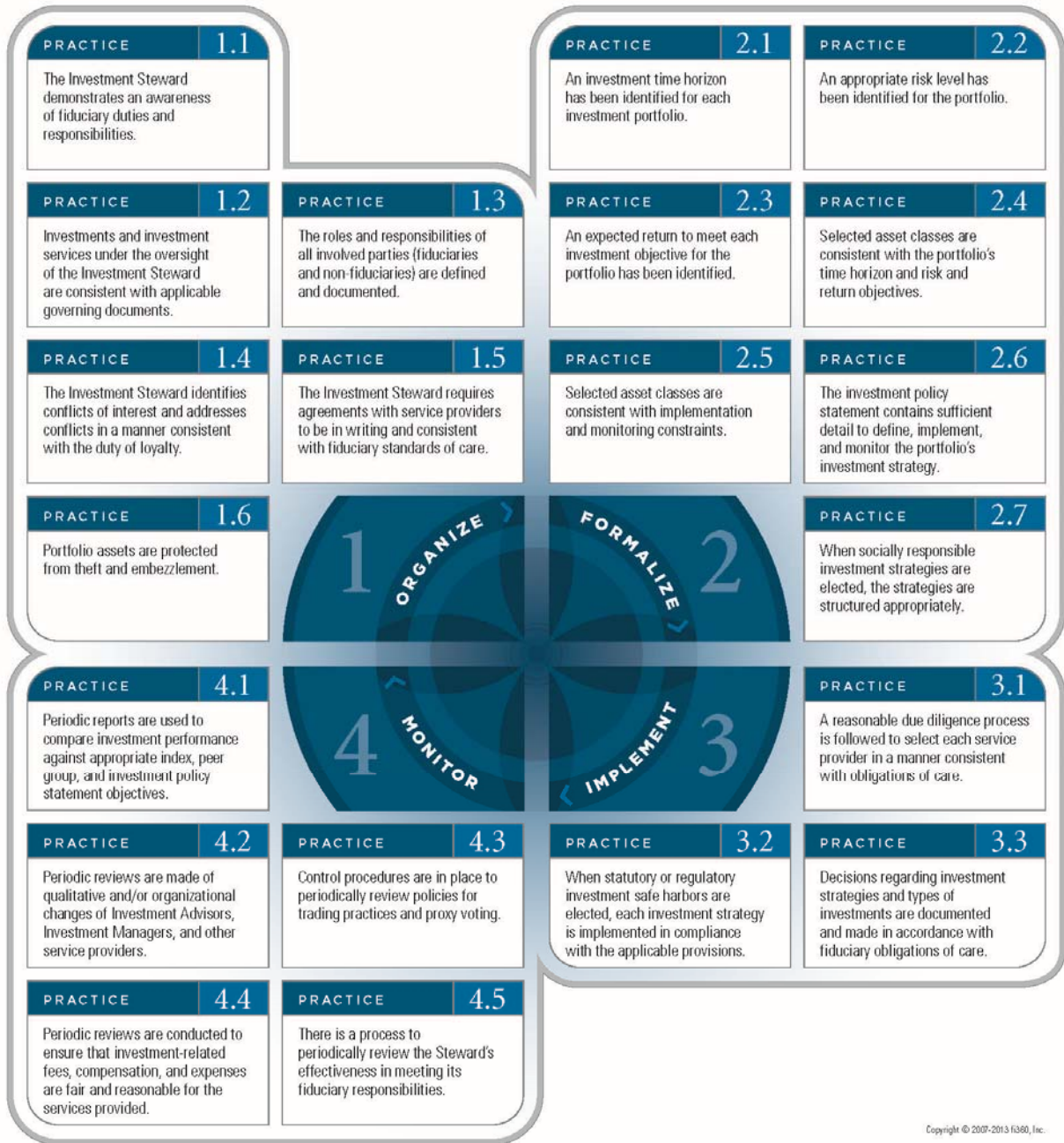
**trading costs** – behind investment management fees, trading accounts for the second highest cost of plan administration. Trading costs are usually quoted in cents per share.

**variance** – A statistical measure that indicates the spread of values within a set of outcomes around a calculated average. For example, the range of daily prices for a stock will have a variance over a time period that reflects the amount that the stock price varies from the average, or mean, price of the stock over the time period. Variance is useful as a risk statistic because it gives an indication of how much the value of the portfolio might fluctuate up or down from the average value over a given time.

**years to recover maximum drawdown** – A measure of a portfolio's efficiency in recovering from large losses. It is calculated by taking the absolute value of the investment's maximum drawdown divided by the investment's 5-year annualized return.



# PERIODIC TABLE OF GLOBAL FIDUCIARY PRACTICES



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Source: fi360 Prudent Practices for Investment Stewards