

# **INVESTMENT POLICY FOR THE STATE OF ILLINOIS EMPLOYEES' DEFERRED COMPENSATION PLAN**

## **Mission Statement**

Pursuant to Article 5/24 of the Illinois Pension Code, the Illinois State Board of Investment (the "Board") is responsible for developing and establishing a deferred compensation plan for employees<sup>1</sup> of the State, which shall be known as the State Employees Deferred Compensation Plan (the "Plan"). In recognition of the Board's role as the named fiduciary to the Plan, the Board has adopted the following Mission Statement:

### **The Plan Mission Statement**

It is the mission of the Plan to allow employees to designate a portion of their compensation<sup>2</sup> to be withheld by the State of Illinois and invested in a manner approved by the Board as a voluntary method of accumulating long-term savings to supplement their retirement income or bridge income between jobs.

## **Statement of Purpose of Investment Policy**

The purpose of this investment policy (the "Policy") is to formalize the Board's investment objectives, policies, and procedures with regard to the assets of the Plan. This Policy may be modified, in whole or in part, by the Board at any point in time. The Board expects to review the Policy periodically.

It is the intention of the Board that the assets of the Plan shall be maintained in compliance with all applicable laws and administrative rules governing the operation of the Plan. In effecting the Policy, all fiduciaries shall perform their duties with respect to the Plan with the care, skill, and diligence that would be applied by a prudent person, acting in a like capacity, and with like aims for the sole interest of Plan participants and beneficiaries.

## **Division of Responsibilities**

The Board, in consultation with Board Staff and an independent investment consultant ("Consultant"), is responsible for the selection and monitoring of the investment options and service providers of the Plan. Pursuant to the Board Bylaws, the Defined Contribution Committee ("DC Committee") is responsible for assisting the Board in performing all duties necessary to manage and oversee the Plan.

The Consultant shall act as Fiduciary to the Plan, and provide services including, but not limited to, monitoring and reviewing Plan and investment manager performance, assisting in maintaining the investment policy, reviewing and reporting on Plan participation, and assisting in evaluating asset classes and investment menu options.

Plan participants are responsible for the allocation of their assets among the investment options of the Plan.

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<sup>1</sup> For purposes of this Policy, the term "employee" has the same meaning as set forth under the Illinois Pension Code (40 Ill. Comp. Stat. § 5/24-102).

<sup>2</sup> For purposes of this Policy, the term "compensation" has the same meaning as set forth under the Illinois Pension Code (40 Ill. Comp. Stat. § 5/24-102).

Investment managers are responsible for selecting individual securities and constructing portfolios to meet an investment option's performance objectives. Investment managers are responsible for communicating any material changes in the process, philosophy, management, and/or performance of the underlying investment strategies, and voting all proxies in the best interests of Participants.

### **Investment Objectives**

It is the Board's intent to offer a sufficient range of investment options with materially different risk and return characteristics to allow Plan participants, by choosing among such investment options, the opportunity to diversify their account balances and construct portfolios consistent with their unique individual circumstances, goals, time horizons, and tolerance for risk. It is also the objective of the Board to offer investment options at a reasonable cost.

### **Investment Options and Structure**

The Board expects to offer different types of investment options to meet various participant investment objectives. Investment options may consist of collective trust funds, other pooled investment vehicles, and/or mutual funds whose eligible investments, investment guidelines, and investment philosophies are governed by a prospectus or similar disclosure. Investment options may also include separately managed accounts that are governed by an investment management agreement which would include investment guidelines. Additionally, the Board may create investment options consisting of the investments described above.

Described below are the various types of investment options to be offered to Plan participants:

#### **Target Date Fund Investment Options**

Target date funds provide a series of asset allocation funds that allow participants to choose a single fund that is based on their expected target retirement date. Each target date fund (e.g. 2045 fund) includes a professionally managed portfolio of underlying investments. The investment manager adjusts and rebalances the allocation of investments over time to reduce the expected risk as each fund progresses toward its target date. Target date fund vintages that reach the end of their de-risking glide path will be automatically discontinued and the assets will be mapped into the target date fund income vintage. Additionally, new target date fund vintages may be added over time to ensure portfolios exist for a broad range of Plan participant target retirement dates.

#### **Asset Class Investment Options**

The Board expects to offer at least one investment option within each of the following broad asset classes:

- Capital Preservation<sup>3</sup>
- Fixed Income
- US Equity
- International Equity

The Board may also establish additional asset classes and investment options at its own discretion to serve the needs of the Plan participants.

#### **Default Investment Options**

The Board recognizes that some Plan participants may fail to make investment choices for their Plan

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<sup>3</sup> Capital Preservation can be defined as either Money Market or Stable Value

accounts, and default investment options are necessary.

- **Default Due to Auto-Enrollment:** Any participant who is automatically enrolled into the Plan will have their contributions invested in accordance with the rules prescribed in the Administrative Code.
- **Default Due to Other Reasons:** A participant who fails to make an investment choice for their Plan account for a reason other than auto-enrollment will be defaulted into the age-appropriate target date fund, based on an assumed retirement age of 65.

### **Selecting Investment Options**

The Board intends to select a combination of investment options consistent with the goals and investment structure outlined in this Policy. All investment option or investment manager additions will be the result of a competitive proposal process with public notice unless the Board, in consultation by Board Staff and Consultant, determines that an emergency procurement is in the best interest of the Plan participants.

The screening process used to select investment options or investment managers for inclusion in the Plan will consider attributes relevant to the specific asset class and search objective, as developed by Board Staff and Consultant. The attributes for passively managed investment options designed to track the return and risk characteristics of a specific index may differ from the attributes considered for actively managed strategies. Attributes may include, but are not limited to, the following:

1. Registration with the Securities and Exchange Commission under the Investment Advisors Act of 1940;
2. A minimum number of years of verifiable firm and team performance history;
3. A minimum number of years for portfolio manager tenure and experience;
4. Robustness of firm's investment philosophy and process;
5. Historical performance and risk review of cumulative, annual, and rolling time periods;
6. Classification of style to determine the basis to compare to other investment managers and investment options with similar investment style/strategy and to determine if there has been deviation from style over time;
7. A minimum level of product and strategy size;
8. Firm's trading, back office, accounting, reporting, and client servicing capabilities; and,
9. Fees.

The screening process for certain categories may differ from the above selection criteria in an effort to identify the most suitable investment managers or investment options. A review and/or evaluation process is expected to consist of the following criteria, as appropriate, and reviews are expected to be conducted in light of full market cycles.

**Quantitative** criteria to be used to select investment options may include, but not be limited to, the following:

- Adherence to stated investment objectives and style discipline over time;
- Historical performance of annual and rolling time periods, and risk metrics such as beta, standard deviation, Sharpe ratio, information ratio, and down-market and up-market capture, versus peers and applicable market index(s);
- Investment management fees and any additional fees (e.g. 12-b1, administrative, redemption); and
- Sufficient investment strategy and fund assets under management.

**Qualitative** (or non-quantifiable) criteria to be used to select investment options may include, but

not be limited to, the following:

- Investment philosophy and process, including the strategy objective, discipline, valuation process, implementation, and research capabilities;
- Personnel structure, including portfolio manager and research team experience, quality, tenure, and turnover;
- Business goals and structure, including ownership, compensation, and incentive practices;
- Demonstrated commitment to operations and technology efficiencies; and
- Willingness, pursuant to contract between the Board, on behalf of the Plan, and the investment manager, to meet specified requirements, including the obligation to meet with Board Staff and Consultant as requested for a review of the performance of the investment option.

The Board will also make best efforts to include representation of emerging investment managers<sup>4</sup> and minority investment managers<sup>5</sup> in the Plan. The Plan will seek to include at least one investment option managed by a certified<sup>6</sup> minority investment manager, unless the Board determines that no such entity exists that conforms to the Board's fiduciary responsibility.

### *Performance Expectations*

Investment options that are actively managed are expected to exceed their respective performance benchmarks net-of-fees, over three to five-year periods or a full market cycle, and rank above median compared to an appropriate peer group universe. Investment options that are passively managed are expected to track their respective performance benchmarks.

### *Risk Tolerance*

The Board recognizes the uncertainty of achieving the stated investment objectives in light of the volatility and complexities of contemporary investment markets. The Board also recognizes that the selection of each investment option<sup>5</sup> involves the assumption of some risk in order to achieve its long-term investment objectives. Each investment option should be selected with consideration to risk and reward over time.

### **Ongoing Investment Option Review and Evaluation**

The Board will review each investment option selected and expect the investment manager to adhere to the terms as defined within this Policy, as well as any negotiated contract between the Board, on behalf of the Plan, and the investment manager. Although the investment options are chosen with long-term expected return and risk profiles in mind, the performance will be reviewed periodically in an effort to identify adverse performance trends and, if necessary, to take steps to rectify them. The Board's investment option performance evaluation will generally be based on both qualitative and quantitative information.

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<sup>4</sup> The term "emerging investment manager" is set forth under the Illinois Pension Code and is defined as "a qualified investment adviser that manages an investment portfolio of at least \$10,000,000 but less than \$10,000,000,000 and is a 'minority owned business', 'female owned business' or 'business owned by a person with a disability' as those terms are defined in the Business Enterprise for Minorities, Females, and Persons with Disabilities Act." (Ill. Comp. Stat. § 5/1-109(4)).

<sup>5</sup> For purposes of this Policy, the term "minority investment manager" includes emerging investment managers and/or minority owned business, female owned business, or business owned by a person with a disability as those terms are defined in the Business Enterprise for Minorities, Females, and Persons with Disabilities Act.

<sup>6</sup> The emerging and/or minority investment manager must provide documentation of a current State of Illinois certification or documentation of a current state issued certification. For an investment manager without a state issued certification, an attestation by the investment manager or General Partner stating that the investment manager or advisor is a "minority owned business", "female owned business" or "business owned by a person with a disability", as those terms are defined by the Illinois Business Enterprise for Minorities, Females and Persons with Disabilities Act, must be provided.

The Consultant is responsible for performing a thorough due diligence on each investment option, monitoring the performance of the Plan's investment options on an ongoing basis, and providing a quarterly report to the Board that addresses the performance of each investment option relative to the appropriate index and peer universe. The Consultant will make recommendations for change, as warranted, to the Board for consideration.

### **Watch List Procedures**

A "Watch List" is utilized for investment options that fail to meet expectations. An investment option may be placed on the Watch List for any of the following reasons:

1. Poor performance relative to assigned benchmark;
2. Excessive risk relative to assigned benchmark as measured by standard deviation;
3. Portfolio rank below median versus peer group;
4. Style drift versus assigned benchmark;
5. Change in the investment management style for which the investment option was retained;
6. Sub-optimal risk characteristics including alpha, beta, Sharpe ratio, information ratio, and tracking error relative to assigned benchmark;
7. Key investment professional turnover;
8. Organizational issues or ownership changes;
9. Excessive out-flows from the firm or product;
10. Violation of ISBI statutory or contractual requirements; or
11. Any other material irregularities where notification to the Board is necessary.

Board Staff and/or Consultant are responsible for making Watch List notifications to the Board for any investment option based on the above factors, using their discretion. The Watch List will be located in the Consultant's quarterly performance report only when a manager is placed on the Watch List.

After notifying the Board of the Watch List status, Board Staff will promptly notify the investment manager of the status verbally and/or in writing. Unless directed by the Board to the contrary, Board Staff shall invite the investment manager to appear at the next regularly scheduled meeting of the Board.

Depending on the infraction, the investment option may remain on the Watch List for a period of time as determined appropriate by the Board, in consultation with Board Staff and Consultant.

The Watch List statuses are set forth below:

**"On Notice"** - If Board Staff and/or Consultant become concerned with one or more of the investment options based upon the Watch List factors, Board Staff and/or Consultant may place the investment option "On Notice." The investment option's failure to improve the Watch List factor(s) at issue within a specific time frame (depending on the infraction) may justify a termination recommendation by Board Staff and/or Consultant to the Board. During the On Notice designation period, Board Staff and Consultant will formulate a recommendation regarding the investment option for the Board's review.

**"Termination"** - If the Board votes to terminate the investment option, Board Staff will promptly notify the investment manager in writing and begin coordinating the procedures for investment option replacement or dismissal as outlined below.

**"In-Compliance"** - If the investment option or investment manager resolves the issues that

brought rise to the On Notice designation, the investment option will be reclassified as “In-Compliance,” upon the decision of Board Staff and/or Consultant, and reported to the Board.

The aforementioned Watch List procedures serves as a guideline for the Board, Board Staff, and Consultant. The Board, as the named fiduciary to the Plan, has discretion to change or deviate from the Watch List procedures at any time as circumstances dictate.

### **Procedures for Plan Investment Changes**

In order to maintain effective communication between the Board and Plan participants, the Board will use reasonable best efforts to limit any Plan investment changes to once annually and to make any Plan investment changes effective on or around July 1 each year. The Board reserves discretion to make Plan investment changes at any point in time, consistent with its fiduciary obligation.

#### *Participant Communication*

The Board will use reasonable best efforts to provide Plan participants with a minimum of 30 days prior notice of any Plan investment change(s).

#### *Investment Option Replacement or Dismissal*

Once the Board has made the decision to terminate an investment option, the investment option cannot remain in the Plan for longer than one year. The Board expects to review the current circumstances to deliberately decide on a prudent and reasonable process for termination and replacement of the terminated investment option. The following procedures outline the process for investment option replacement or dismissal:

1. Notice will be given to the terminated investment manager with a timeline for divestiture.
2. A date will be selected to freeze any new deferrals or transfers into the investment option, if applicable.
3. Participants will be given notice of the closure / liquidation, effective dates, and a time period no less than 30 days but not to exceed one year.
4. Participants will be granted an opportunity to direct their balances in the to-be terminated investment option to one of the other investment options prior to the termination date. Balances not directed by participants will be transferred or “mapped” to the Plans’ investment option(s) the Board deems appropriate.

### **Summary**

The Plan is a long-term retirement savings program and the guidelines set forth in this Policy must consider a consistency of performance compared to set benchmarks and peer groups over the longer term rather than relying on an occasional exceptional year or short period of poor performance. Therefore, emphasis is placed on the long-term objectives of the investment options. Interim performance reviews are conducted to continually monitor the investment options to detect any significant changes or irregular progression that may prove to be outside the realm of the occasional short-term underperformance.

### **Plan Administration**

The administrative rules governing the operation of the Plan are overseen by the Joint Committee on Administrative Rules (“JCAR”). The Administrative Code for the Plan is located here: <http://www.ilga.gov/commission/jcar/admincode/080/08002700sections.html>. The Board continually monitors and amends its administrative rules. ISBI operates according to Board-approved rules. There may be a delay before Board-approved rules are published in the Administrative Code.

The Department of Central Management Services (“CMS”) administers the Plan, subject to the general supervision of the Board. CMS has authority to manage and administer internal management procedures to implement and maintain the Plan.

The Board is responsible for monitoring and evaluating the Plan’s administrative services expenses and participant administrative fees. The specific guidelines that the Board expects to follow are outlined in the Administrative Fee Policy in Appendix A.

Plan participants are able to apply for and receive a loan from their Plan account balances in accordance with the Plan’s Administrative Code and Loan Program Policy, which is located on ISBI’s and CMS’s websites.

### **Exceptions**

Any changes to this Policy must be made in writing and approved by the Board.

### **History of Amendments**

Adopted:	March 24, 2006
Amended:	June 30, 2006
Amended:	October 28, 2008
Amended:	June 15, 2012
Amended:	June 27, 2014
Amended:	September 17, 2015
Amended:	December 15, 2016
Amended:	December 13, 2019
Amended:	December 8, 2020
Amended:	March 23, 2022

## **APPENDIX A: ADMINISTRATIVE FEE POLICY FOR THE STATE OF ILLINOIS EMPLOYEES' DEFERRED COMPENSATION PLAN**

### **Purpose**

The Administrative Fee Policy Statement is intended to serve as a guideline for the Board to monitor and evaluate the Plan's administrative services costs and fees.

### **Background**

The Plan's expenses and related fees can be split into two general categories; investment management and administrative services. Investment management expenses are associated with investing participants' assets. Administrative services include all other services to run the Plan, including but not limited to recordkeeping, accounting, legal, trustee services, internal staffing, investment consulting, insurance, customer service, and participant communications.

Investment management expenses are collected by the investment manager through each fund's expense ratio, which reduces fund performance accordingly. Participants are charged additional administrative fees to cover all known or expected Plan administrative expenses. The way in which participants are charged is known as the administrative fee structure.

### **Core Beliefs**

- The Board recognizes that the Plan does not receive any external funding from participating employers or from the State of Illinois to offset its administrative services expenses. Therefore, the Board believes it is reasonable to charge participant fees to cover all administrative expenses and to provide the Plan with sufficient operating cash reserves.
- The Board expects to review the Plan participant fees and fee structure on a periodic basis to ensure continued reasonable alignment with the Plan's administrative expenses.
- The Board expects to review the Plan's administrative expenses periodically to ensure reasonableness.
- The Board expects to establish an operating cash reserves target, with a corresponding minimum and maximum threshold, to ensure continued reasonableness.

### **Process**

#### **Administrative Expenses**

1. The Board expects Board Staff to present their fiscal year budget for expected internal expenses related to the Plan. Internal expenses generally include, but are not limited to, staffing, legal, insurance, technology, and facilities.
2. The Board expects CMS to present their fiscal year budget covering the expected expenses associated with servicing the Plan. Expenses generally include, but are not limited to, staffing, legal, insurance, technology, and facilities.
3. The Board expects to evaluate, monitor and benchmark the Plan's administrative expenses associated with external vendor services (recordkeeping, consulting, etc.) periodically.



4. Based on the review of Board Staff, CMS, and external vendor services expenses, the Board may decide to change the Plan administrative fees or fee structure applied to participant accounts.

### Operating Cash Reserves

1. The Board expects the Plan to hold an operating cash reserves balance. The purpose of the reserves balance is to ensure that the Plan can continue to operate smoothly and efficiently, while being able to accommodate any unexpected plan administrative expenses, future project expenses, day-to-day operating cash needs, and potential increases in plan expenses over time. While there is no observed industry standard for an operating cash reserves balance, the Board, in consultation from Board Staff, CMS and the Consultant, have determined the below parameters are reasonable for the Plan. The Board may change or update these parameters at any time.

	<b>Operating Cash Reserves Target</b>	<b>Range</b>
Annual Plan Administrative Expenses	100%	+/- 50%

2. There are two operating cash reserve accounts, one held at the recordkeeper, and one held at CMS. For purposes of monitoring the operating cash reserve levels, the Board expects to combine these two account balances. The Board expects Board Staff and CMS to coordinate appropriate levels held within each account.
3. Should the operating cash reserves breach or are expected to breach the established minimum or maximum thresholds, the Board will work with Board Staff, CMS, and Consultant to determine a plan to bring the operating cash reserves closer to target within a timely manner.

### Administrative Fees

1. The Board expects to compare the Plan's total administrative fees to the total administrative expenses on a periodic basis to ensure reasonable alignment. It is understood that there may be differences between fees and expenses in any given period or year, and that fees may be higher or lower than expenses due to market conditions, participant growth trends, and/or actual or expected expenses. The Board does not expect to change the administrative fee or fee structure based on short-term trends, but may consider adjusting the fee due to observed or expected longer-term trends.
2. The Board expects to benchmark the administrative fee and fee structure periodically.