



**STATE OF WISCONSIN**  
**Department of Employee Trust Funds**

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**CORRESPONDENCE MEMORANDUM**

**DATE:** March 14, 2006  
**TO:** Deferred Compensation Board Investment Committee  
**FROM:** Shelly Schueller  
**SUBJECT:** WDC Fixed Investment Options

Department staff has been reviewing the growing number of investment options in the Wisconsin Deferred Compensation (WDC) Program. Further discussion regarding the idea of consolidating two of the fixed options, the Federal Deposit Insurance Corporation (FDIC) and the Vanguard Money Market fund, may be warranted. In addition to these two money market options, the WDC also provides a money market account through the Schwab Self-Directed Option. The table below provides data on WDC participant use of the core fixed investment options currently offered by the WDC.

<b>WDC Fixed Investment Options (as of December 31, 2005)</b>						
	Year added to WDC	WDC Participant Accounts	% all WDC Participants	Average Account Balance	Assets in Option	% of all WDC Assets
FDIC (M&I Bank)	1991	2,608	6.09%	\$11,540	\$30,096,788	1.70%
Money Market (Vanguard)	1992	10,375*	24.23%	\$6,485	\$67,281,261	3.80%
Stable Value (Galliard)	1998	15,761	36.81%	\$20,452	\$322,338,283	18.19%
Barclays US Debt Index	2001	2,792	6.52%	\$3,444	\$9,616,675	0.54%
Fed. 2-5 Yr. Gov't Bonds	1992	3,667	8.56%	\$4,791	\$17,569,224	0.99%
Van. Long Term Inv. Grade	1992	10,018	23.40%	\$6,360	\$63,716,757	3.60%
<b>Total WDC Participant Assets</b>					<b>\$1,772,146,803</b>	

\* The number of accounts is higher than normal for the Vanguard Money Market fund due to the closure of three funds in the last two years and subsequent defaulting of accounts balances to the money market account. In December 2003 there were 3,544 money market accounts. With the closure of the Dreyfus Third Century Fund in December 2004, 1,849 accounts were defaulted to the money market. Additional accounts were defaulted with the closure of the Janus Fund (4,613) and the T. Rowe Price International Fund (4,456) in December 2005.

Reviewed and approved by Dave Stella, Deputy Secretary	
Signature _____	Date _____

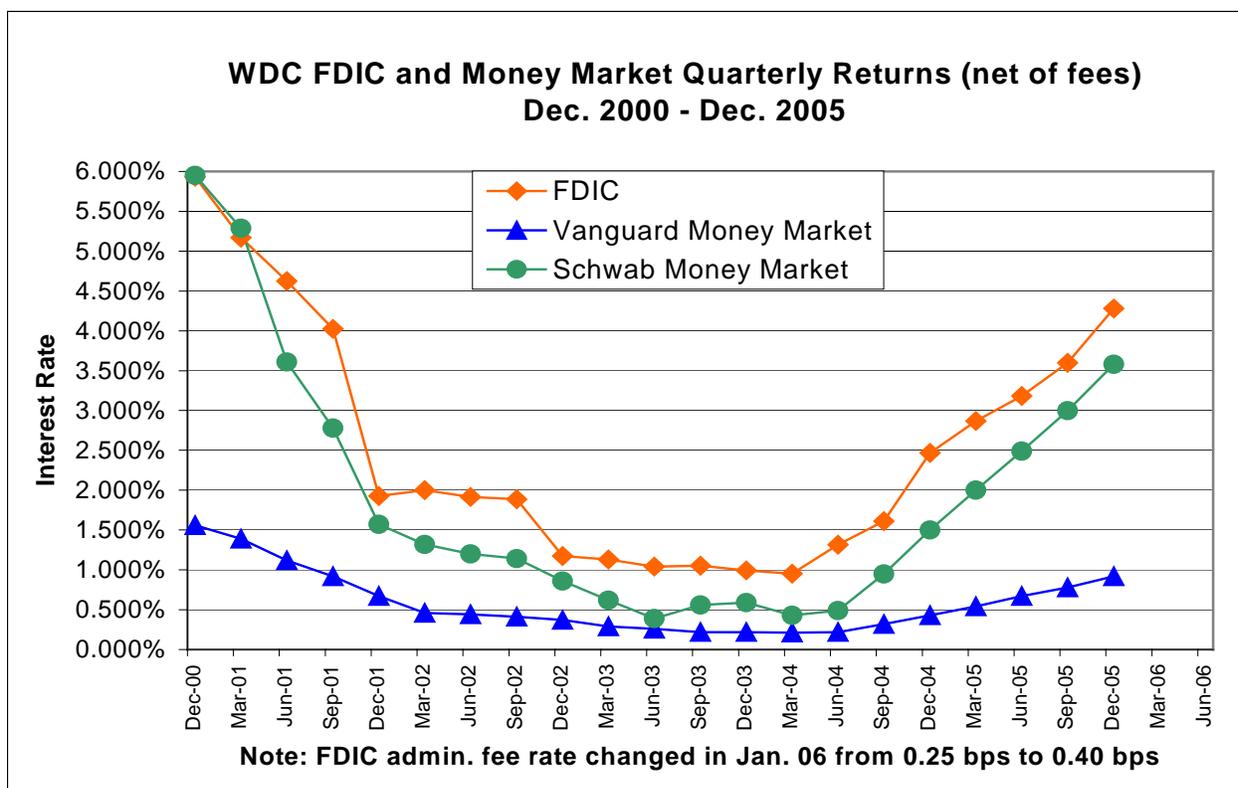
Board	Mtg Date	Item #
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FDIC Option

Beginning in January 2006, the FDIC option has been a two-part FDIC account: a money market account and a "NOW" transactional/checking account with interest. The FDIC insures NOW accounts just like it does money market accounts. This two-account arrangement permits WDC participants to move money daily in and out of the checking account, with an aggregate trade being done at the end of the week into the savings account. However, WDC participants have lost 15 basis points of interest when compared to the previous FDIC agreement. This is because M&I replaced the previous spread of 25 basis points with a 40 basis point spread.

Advantages to Consolidating FDIC and Money Market

- Would provide insurance for participants. Participant FDIC accounts are currently insured up to \$100,000 by the FDIC. As a result of the federal Deficit Reduction Act of 2005, the insurance amount will increase to \$250,000 on April 1, 2006. Vanguard Money Market accounts do not provide FDIC insurance.
- Competitive rate of return. Over the last five years, the FDIC option offered through M&I Bank has consistently provided a higher rate of return than the Vanguard Money Market option. (see graph)



- Reduces, by one, the overall number of investment options for WDC participants without losing a money market option; the Schwab Self-Directed Option provides a money market.
- Preservation of principal upon default. If the Board designated the FDIC as the default option, participants whose account balances defaulted would be guaranteed preservation of principal through the FDIC insurance.

- Reduces the number of competing funds requiring an “equity wash,” or intermediate transfer to an equity fund, prior to receiving assets transferred from the Stable Value Fund.
- Potential reduction in confusion among participants about small differences in fixed investment options.
- Potential reduction in cost due to Board’s Investment Policy Statement requirement that fixed options are selected through a competitive bid (Request for Proposal) process. See table of fixed option participant expenses.

<b>Fixed Option Participant Expenses</b>	
<b>Option</b>	<b>Expense</b>
FDIC (@ M&I Bank)	As of Jan. 2006, blended fixed/floating rate less a spread of 0.40 bps, reset quarterly (previously 0.25 bps)
Money Market (Vanguard Admiral)	0.13% of assets
Stable Value Fund (@ Galliard)	Performance is net of management fees of approx. 0.21%
Barclays US Debt Index	0.05% of assets
Federated 2-5 Year Government Bonds	0.57% of assets
Vanguard Long Term Investment Grade	0.19% of assets

#### Disadvantages to Consolidating FDIC and Money Market

- Board would need to designate a new default option when closing a fund.
- Would likely require a Request for Proposal. Per the Board’s Investment Policy Statement: “fixed income investments...are selected from a competitive request for proposal process.”
- Although unlikely, participants might possibly lose some trading flexibility because the FDIC option has the two account (“NOW” and money market) feature to address Regulation D requirements limiting transactions on FDIC money market accounts to six per month.
- Reduces the overall number of fixed options for WDC participants.

#### Recommendation

Staff recommends further review regarding consolidating the FDIC and Money Market options. If the Investment Committee concurs, staff will work with Advised Assets Group to prepare additional analysis for presentation and discussion at a future Investment Committee meeting.