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CORRESPONDENCE MEMORANDUM

DATE: August 10, 2006

TO: Deferred Compensation Board Investment Committee

FROM: Shelly Schueller

SUBJECT: WDC Fixed Investment Options Review

At your March 2006 meeting, you requested a further review of the fixed investment options in the Wisconsin Deferred Compensation (WDC) Program. Based on the analysis outlined in this memo, Department staff is proposing that the Investment Committee continue to closely monitor the returns of the FDIC and Money Market options for another twelve months. If the FDIC option continues to outperform the Money Market option during this extended period, then staff suggests that the Investment Committee consider recommending a consolidation of the FDIC and Money Market options to the full Board.

The table below provides data on WDC participant use of the core fixed investment options currently offered by the WDC as of June 30, 2006.

WDC Fixed Investment Options (as of June 30, 2006)

	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	2,625	6.09%	$13,099	$34,385,242	1.85%
Money Market* (Vanguard)	1992	10,574*	24.54%	$5,812	$61,462,349	3.31%
Stable Value (Galliard)	1998	15,693	36.43%	$21,523	$337,753,148	18.18%
Barclays US Debt Index	2001	2,803	6.51%	$3,537	$9,914,115	0.53%
Fed. 2-5 Yr. Gov't Bonds	1992	3,698	8.58%	$4,767	$17,627,413	0.95%
Van. Long Term Inv. Grade	1992	10,049	23.33%	$5,824	$58,524,788	3.15%
Total WDC Participant Assets (all investment options)					$1,858,198,846	

Reviewed and approved by Dave Stella, Deputy Secretary

Signature ____________________ Date __________

Board	Mtg Date	Item #
DCIC	09/12/2006	3

* The number of accounts is higher than normal for the Vanguard Money Market fund due to the closure of three investment options in the last two years and subsequent defaulting of account 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.

FDIC Option

Since 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 portion of the account. However, under the new arrangement, 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 in the administrative fee, which was 25 basis points, with a spread of 40 basis points.

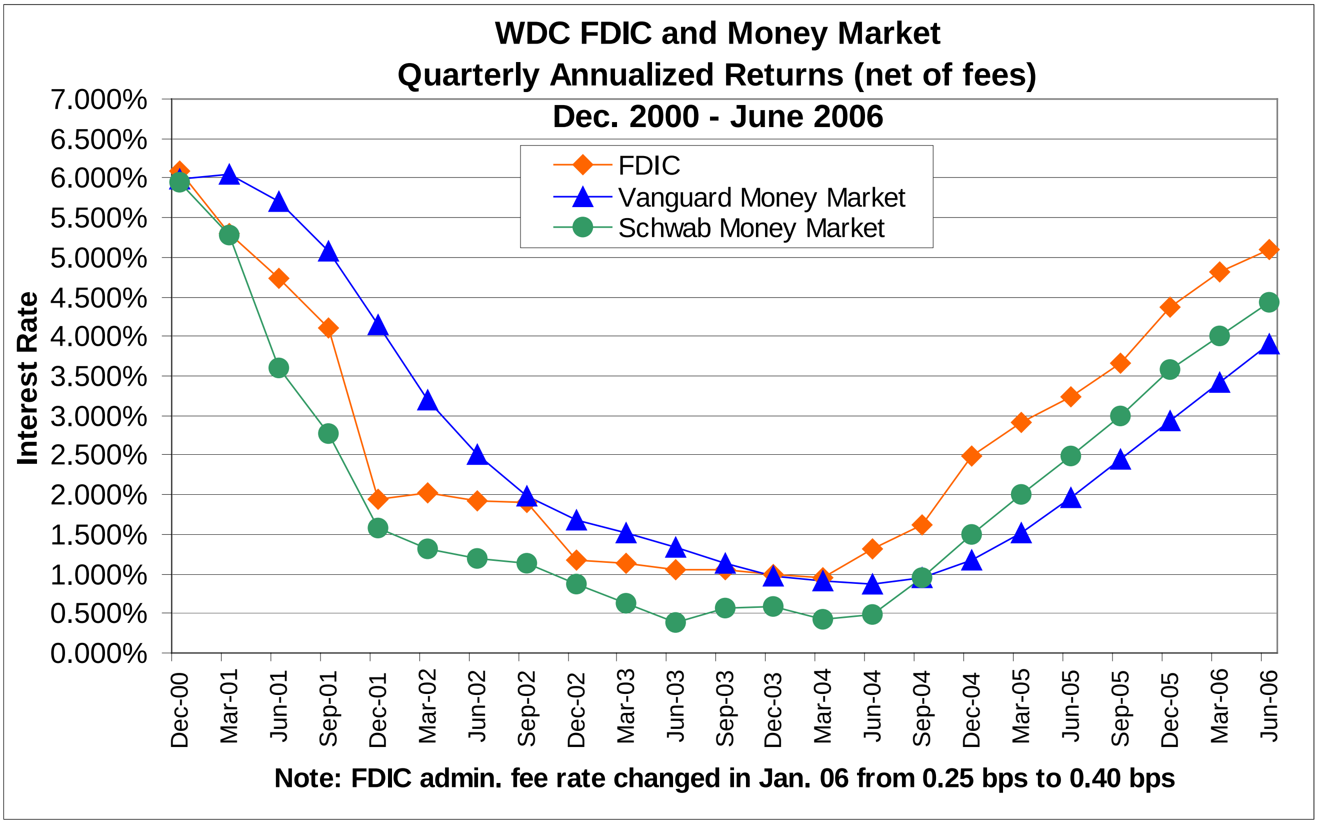
Advantages to Consolidating FDIC and Money Market

There are several advantages to consolidating the FDIC and Money Market funds. Consolidation would:

- Provide guaranteed insurance for participants' investments. As a result of the federal Deficit Reduction Act of 2005, the insurance amount for participant FDIC accounts has increased from $100,000 to $250,000. The Vanguard Admiral Treasury Money Market Fund is a low-risk investment, maintaining very high credit quality by investing 100% of its assets in Treasury securities backed by the full faith and credit of the U.S Government. However, these accounts do not provide any guarantees such as FDIC or similar insurance on a participant level. FDIC-like insurance options are not currently available to WDC participants through the Schwab Self-Directed Brokerage (SDB) option.

- Preserve 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.

- Provide a competitive rate of return. Since March of 2004, the FDIC option offered through M&I Bank has provided a higher rate of return than the Vanguard Money Market option and the Schwab SDB money market option. See graph on page three.



- Reduce 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.

- Reduce, by one, the overall number of investment options for WDC participants without losing a money market option; the Schwab SDB option would continue to provide a money market fund. This would bring the total number of investment options offered by the WDC closer to those of other similar plans, which generally have fewer fixed investment options than the WDC. In a review of the thirty largest plans they administer, for example, Great West found:

    1. The number of fixed options (including stable value funds, insurance company general products, money market funds and bond funds) ranged from one to six.

    2. The average offering was 3.4 fixed options, with the mean being three.

    3. The most frequent line-up was a stable value fund and two bond funds.

- Potentially reduce confusion among participants about small differences in fixed investment options.

- Potentially reduce costs due to the Board's Investment Policy Statement requirement, which requires that fixed options be selected through a competitive bid

(Request for Proposal) process. See table of fixed option participant expenses below.

WDC Fixed Options and Participant Expenses	
Option	**Expense**
FDIC (@ M&I Bank)	As of Jan. 2006, blended fixed/floating rate less a spread of 0.40 bps, reset quarterly (previous rate was 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

There are several perceived disadvantages to consolidating the FDIC and Money Market funds. Consolidation would:

- Require the Board to designate a new default option when closing a fund.
- Likely involve the completion of a Request for Proposal process. Per the Board's Investment Policy Statement: "fixed income investments…are selected from a competitive request for proposal process."
- Result in a potential loss of trading flexibility for participants 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. The potential for this loss is small.
- Reduce the overall number of fixed options for WDC participants.

Recommendation

Department staff proposes that the Investment Committee continue to closely monitor the returns of both the FDIC and Money Market funds for another twelve months. If the FDIC option continues to outperform the Money Market option during this extended period, despite the 0.15 bps increase in the FDIC administrative fee, then staff suggests that the Investment Committee consider recommending a consolidation of the FDIC and Money Market options to the full Board.