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CORRESPONDENCE MEMORANDUM

DATE: November 2, 2009

TO: Wisconsin Deferred Compensation Board

FROM: Shelly Schueller, Director
Wisconsin Deferred Compensation Program

SUBJECT: FDIC Fixed/Floating Interest Rate Decision

Staff recommends that the Board approve Advised Asset Group's FDIC interest rate recommendation for 2010 and allocate 75% of the allocation to the fixed portion and 25% to the floating portion.

M&I Bank of Southern Wisconsin has been under contract to offer the Federal Deposit Insurance Corporation (FDIC) bank option for Wisconsin Deferred Compensation (WDC) Program participants since January 1, 2001. WDC participants holding assets in the FDIC account receive a blended rate of interest based on the fixed/floating interest rate allocation selected by the WDC Board.

The contract between the Board and M&I Bank permits the Board to change the percentage allocated to the fixed and floating interest rate for the following year, provided the Board gives M&I Bank a 30 day notice.

To determine the interest rate that will be applied to participant accounts in 2010, action is needed by the Board at the November 2009 meeting to set the percentage of the FDIC account assigned to the fixed and floating interest rate calculation. The attached memo from Alex Roitz at Advised Assets Group (a division of Great-West Retirement Services) provides background on the recommended allocation for 2010.

Mr. Roitz recommends that the Board consider allocating seventy-five (75%) of the allocation to the fixed portion and the remaining twenty-five percent (25%) to the floating portion. Staff concurs with this recommendation. It is the same allocation that the Board selected for the past two years, and appears prudent given the volatility and continued worldwide economy uncertainty.

Mr. Roitz and Department staff will be available at the meeting to discuss this recommendation.

Attachment

Reviewed and approved by Robert J. Conlin, Deputy Secretary.

Signature ______________________ Date ______________________

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AdvisedAssetsGroup
Put Our Power Behind You℠

Memorandum

To: Shelly Schueller, Director,
Wisconsin Deferred Compensation Program

From: Alex Roitz, Senior Analyst,
Advised Assets Group

Date: October 23, 2009

Re: Allocation for the FDIC Option

The M&I Bank of Southern Wisconsin permits the Wisconsin Deferred Compensation Board (the Board) to set the allocation of the FDIC option used in calculating the interest rate. The allocation is composed of a floating rate portion based on the 3 month LIBOR less .40% reset each quarter and a fixed portion based on the 12 month LIBOR less .40% reset annually.

Typically taking advantage of this blended rate requires setting a higher allocation to the floating portion (3 month LIBOR) in a rising interest rate environment. Conversely, in a falling interest rate environment a higher allocation to the fixed portion (12 month LIBOR) is more beneficial. However, given current economic conditions we may want to examine the situation a bit differently this time.

The recession officially began in December 2007, and while the end of the recession is yet to be determined, optimism within the market and economy has taken a foothold. There is still much debate about how this recovery will play out. Some predict a fast rise from the bottom while others talk about a slow slog. Whatever the case, economic signs have been mostly positive, the S&P 500 is up 62% from the March 9 low, leading economic indicators are up, spreads have tightened, and the yield curve has steepened. The Government has worked to keep interest rates low in an effort to keep the economy on track. Currently, the Fed Funds rate is between 0 and 0.25%. Most economists do not expect the government to adjust this short-term target rate until the economy is more stable. Some estimates call for an adjustment upward in late 2010, while others think mid 2011 is more likely.

Predicting the direction of short-term interest rates has been historically challenging. This time is no different given current interest rates and the state of the economy. However, inflation is in check and looks to remain there for some time. In addition, the steepness of the yield curve works to our advantage. The current 3-month Treasury rate is 0.03% while the 2-year Treasury is at 1.00%. Meaning short-term rates would need to rise significantly in order to surpass rates just slightly further down the yield curve. Further enhancing the cushion is the low probability of an increase in the Fed Funds rate, somewhere between 0 and 10% according to current futures contracts.

As of 10/23/09, current 3-month LIBOR is 0.28% and 12-month LIBOR is 1.23%. These rates, in conjunction with the above factors lead AAG to recommend a 75% allocation to the fixed portion and a 25% allocation to the floating portion. However, should the Board care to hedge against the possibility of an unexpected floating rate increase; a 50/50 split would also be prudent.

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