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CORRESPONDENCE MEMORANDUM

DATE: February 6, 2012

TO: Wisconsin Deferred Compensation Board Investment Committee
Wisconsin Deferred Compensation Board

FROM: Shelly Schueller, Director
Deferred Compensation Program

SUBJECT: BlackRock Laddered Bonds Concept

This memo is for informational purposes only. No action is required at this time.

The December 12, 2011, edition of *Pensions and Investments* contained a front page news article entitled "Federal Reserve DC plan launches stable value alternative". The stable value alternative introduced in the article is a laddered bonds concept developed by BlackRock, Inc.

Staff from BlackRock will be at the Investment Committee meeting to discuss this new fixed-income option, which they call "Target Term," including why it was created and how it is being received by plan providers and participants.

Staff from the Department of Employee Trust Funds and BlackRock will be at the Investment Committee meeting to answer any questions you may have.

Attachments: "Federal Reserve DC plan launches stable value alternative"
Pensions and Investments, December 12, 2011
BlackRock Overview and Low Risk Defined Contribution Strategies

Reviewed and approved by Matt Stohr, Administrator,
Division of Retirement Services

Matt Stohr 2/15/12

Signature Date

Board	Mtg Date	Item #
DCIC	02/28/2012	3

Pensions&Investments

Federal Reserve DC plan launches stable value alternative

The Fed's defined contribution plan shifts to new laddered bond approach

BY ROBERT STEYER
Published: December 12, 2011

Worrying: Restrictions imposed by GIC providers were one concern of William Clark and other plan officials.

The Federal Reserve Employee Benefits System is using an innovative form of bond laddering in its $5.5 billion defined contribution plan to replace the GIC-laden stable value option that had been its most popular with participants.

The change was necessary "to introduce new fixed-income options that offered certainty of returns but did not have the concentration of risks from investing in guaranteed investment contracts," William Clark, chief investment officer of the Newark, N.J.-based Federal Reserve Office of Employee Benefits, said in an interview.

Investments in the stable value fund had been 100% in GICs until the fourth quarter of 2008, when plan officials began investing new participant contributions and maturing GICS into a prime money market fund they incorporated into the stable value option, known as the Interest Income Fund.

Mr. Clark said plan executives were concerned that there were GICs from only seven insurance companies in the Interest Income Fund, and only three of them were offering new contracts. "A secondary concern was that the plan restrictions imposed by the GIC issuers limited the plan's flexibility to introduce new investment options and change various plan provisions," he said.

Plan officials began phasing out the internally managed stable value option in July. That option had been offered since 1970.

In its place, plan officials launched a series of three bond funds — the Select Maturity Bond Family — with maturity dates of June 30, 2014; June 30, 2016; and June 30, 2018. "This allows the participants to invest in the equivalent of a CD (certificate of deposit) ladder or a bond ladder," said Mr. Clark, adding that most participants choosing this option have invested in all three maturities.

The new bond-fund family is managed by BlackRock Inc., New York, which also manages a bond index fund and a Treasury inflation-protected securities index fund for the Federal Reserve's plan. (The plan also offers a passive Government Securities Fund, managed by State Street Global Advisors.)

Each of the new BlackRock funds will invest in U.S. Treasuries, other U.S. government agencies, foreign governments, corporate debt and securitized-debt-backed by a loan, lease or mortgage.

The allocation to the five sources varies with the length of maturity of the funds within the bond family. "There are strict credit and diversification requirements in order to limit the potential for — and exposure to — defaults in the underlying portfolio," Mr. Clark said.

Change accepted

Early results indicate participants have accepted the change, he added.

When the bond family option was launched, the Interest Income Fund accounted for 52.3% of plan assets. Now, that's down to 38%, and the bond family fund accounts for 15% of assets, indicating to Mr. Clark that the "vast majority" of money leaving the Interest Income Fund went into the new bond family funds.

The Interest Income Fund is being phased out in stages. In six-month intervals, a portion of participants' balances will be reallocated; the default option is one-third each into the three Select Maturity bond funds.

DC plan officials began talking with representatives from BlackRock in mid-2010 about developing a new fixed-income option. "We approached BlackRock because they were the only investment manager at the time that offered products that had some of the elements of what we wanted to achieve," Mr. Clark said.

The result was a structure "that behaved much like CDs with full liquidity prior to maturity," Obie McKenzie, a New York-based managing director in BlackRock's global client group, said in an e-mailed response to questions.

The Federal Reserve is BlackRock's first defined contribution client for the bond-family offerings, Mr. McKenzie said. He added company officials are in "active discussions" with executives at other DC plans.

In seeking a new fixed-income option, Mr. Clark said plan executives set several goals: flexibility, such as no transfer restrictions; high-credit quality and diversification; and certainty of returns if held to maturity.

The bond fund family option is being valued on a daily basis, whereas the Interest Income Fund is valued monthly. The bond fund family allows daily withdrawals and deposits; the Interest Income Fund allows these transactions monthly.

A new bond fund will be added to the Select Maturity Bond family to replace a maturing fund every two years. For example, a fund maturing in 2020 will be added to the investment lineup in 2013.

The Select Maturity Bond fund family isn't the only change to the Federal Reserve's DC Plan.

- The number of target-risk funds was cut to three from five "to reduce complexity to participants," Mr. Clark said. These options are constructed using the DC plan's core options. Ayco Co., a subsidiary of Goldman Sachs Group, determines the asset allocation percentages for each fund once a year, Mr. Clark said.
- A passively managed emerging markets collective investment trust, managed by Northern Trust Corp., was added. Plan officials chose the emerging markets option following an asset allocation study that showed such an option would produce "a significant enhancement in potential risk-adjusted returns for diversified portfolios at various levels of risk," Mr. Clark said. Northern doesn't manage any other options for the Federal Reserve plan.
- An active domestic large-capitalization equity separate account was merged into a passively managed equity blend fund managed by Vanguard Group. The large-cap option, which was co-managed by BlackRock and Davis Select Advisors, was terminated for "performance reasons," Mr. Clark said.

Original Story Link: http://www.pionline.com/article/20111212/printsub/312129977

BlackRock®

State of Wisconsin Deferred Compensation Board

BlackRock Overview and Low Risk Defined Contribution Strategies

February 28, 2012

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I. BlackRock Overview and Defined Contribution Capabilities

BlackRock's institutional philosophy

Our philosophy is to deliver investment excellence through partnership with clients

We apply our capital markets expertise to benefit clients

- Investment professionals share local insights across asset classes and regions in pursuit of generating strong risk-adjusted returns
- Our broad industry experience enables us to innovate across products, services and vehicles—including mutual funds, ETFs, commingled funds, and separate accounts

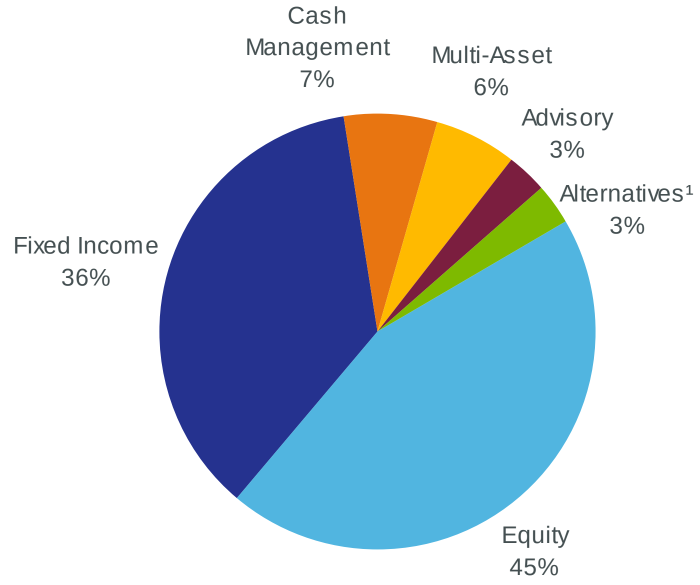
Our culture embodies risk management

- Firm founded upon rigorous risk management principles
- Independent risk professionals help ensure portfolio risk is deliberate, diversified and appropriately scaled
- BlackRock Solutions® provides independent risk management and enterprise investment services for $10 trillion in assets*

We carefully align service with our clients' needs

- We are truly independent – never trading on our own account
- We integrate corporate governance practices to protect and enhance the economic value of the companies in which we invest
- We provide all facets of transition management services to help clients realize new investment strategies while minimizing disruption

Expertise across asset classes



$3.51 trillion in assets as of 31 December 2011
¹Includes commodity and currency mandates

* Assets as of 31 December 2011

Defined Contribution at BlackRock: first class service & solutions

Commitment to Defined Contribution as a strategic business

- Experienced and multi-disciplined dedicated DC team of over 75 people
- Manage over $350 billion* for over 400 DC clients in the US
- Strong asset management brand and reputation

Powerful thought leadership

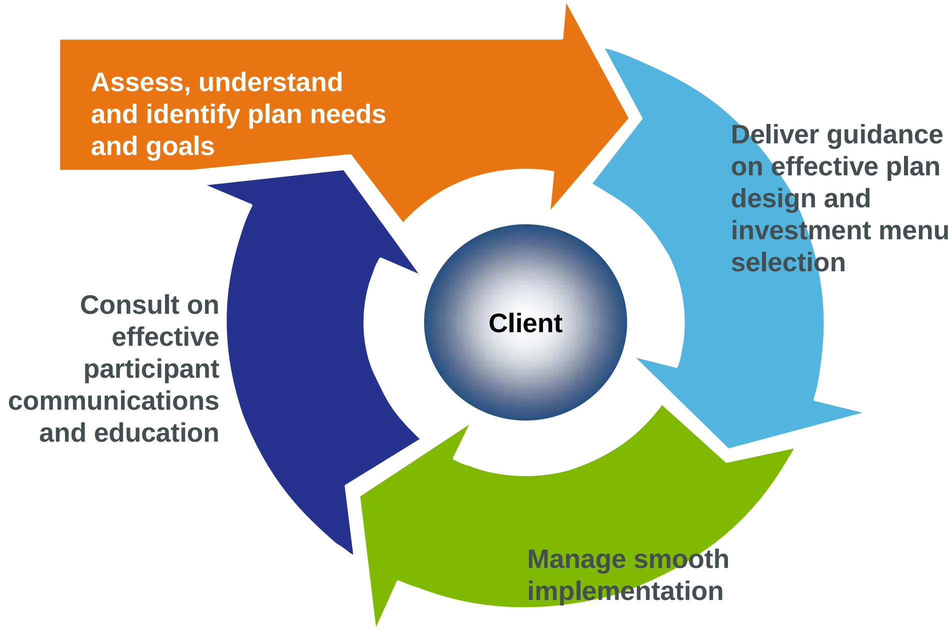
- Strong understanding of participant behavior drives guidance on optimal plan design and investment solutions
- DC-specific market insight and best practices applied and delivered through various mediums
- Leader in developing innovative and successful pre- and post-retirement solutions

Wide array of top quality investment products

- Singular focus on delivering performance while managing risks
- Access to the best investment ideas across all asset classes, disciplines and vehicles
  - Created first lifecycle fund (LifePath® Portfolios) in 1993
  - Created LifePath Retirement Income®, designed to provide secure retirement income
  - Institutional quality funds provide asset class exposure and/or multi-asset solution: BlackRock Global Allocation, Capital Appreciation, Strategic Completion, etc

Client-Centric Approach:

Committed to an Ongoing & Dynamic Partnership



* Assets as of 31 December 2011

DC Observations – Plan Trends & 2012 Agenda

Structural reviews in preparation for participant fee disclosure – *mostly complete*

- More "unbundling" - fewer mega & large DC plans fully bundled with recordkeeper
- Significant uptake in index management – for core options and target date funds

QDIA review – *ongoing*

- 5 year anniversary of the Pension Protection Act
- Performance disparity amongst TDF managers – more awareness of how TDFs' objectives differ

Stable Value assessment – *early stages*

- Particularly for the mega-plans, concerns about wrap capacity, investment guidelines & yields
- Second half of 2011 saw several providers reducing STV programs or eliminating them altogether
- A nascent trend towards rethinking the low risk end of the investment spectrum for better options

Core Option review – *mid-term*

- The search for yield drives interest in dividend or specialized income strategies (equity, fixed income)
- DB's "Globalization" trend comes to DC with greater interest in global exposures
- Core Options vs Target Date Funds – need for additional diversifying asset classes to build optimal portfolios

Retirement Income education – *ongoing*

- Industry conferences, "first mover" plan sponsors and consultants all generating attention and interest
- DB-plan funding challenges reassert the DC plan's need to provide retirement security for participants

Participant Communications – *resurging*

- Keen interest in new ways of capturing participant attention – video, interactive materials, social media
- Targeting specific audiences with appropriate messages (by age or savings "mistakes")

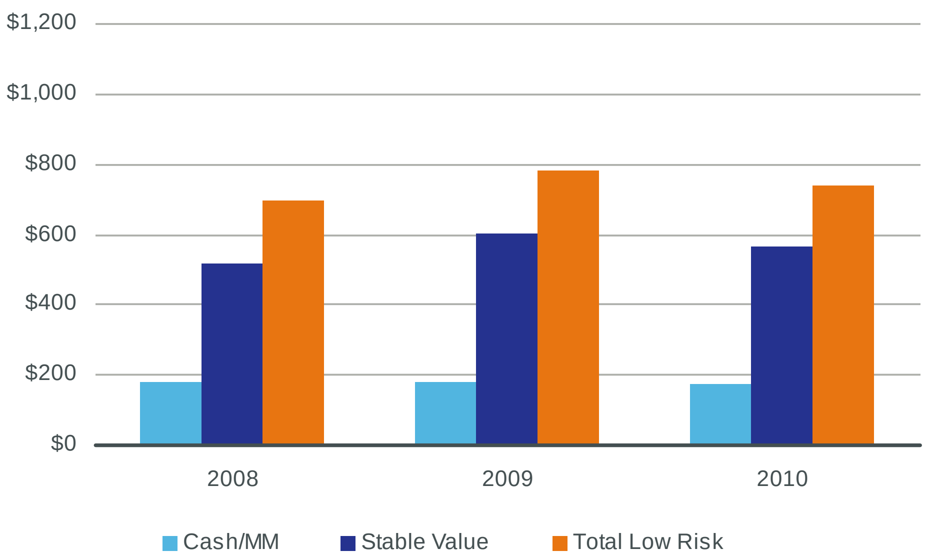
II. Market Outlook & Review

The role of lower risk investment options in DC plans

Plan Sponsors have traditionally used lower risk strategies such as Money Market or Stable Value funds as default options prior to the QDIA regulation

Market volatility and price dislocations in 2008/2009 highlighted considerable risks in these lower-risk options

DC assets in lower risk investments options[1]



Core options offered in DC plans[2]	2009
Stable value	**82%**
Domestic equity (actively managed)	81%
Intl/Global equity (actively managed)	77%
Core bond	79%
Domestic equity (passively managed)	56%
Money market	**49%**
Intl/Global equity (passively managed)	31%
Emerging markets	28%
Employer stock	24%
Real estate	21%
Self-directed brokerage window	18%
Sector funds	11%
TIPS	9%
Mutual fund window	9%

1 Federal Reserve, LIMRA/SVIA
2 Deloitte/CEBS, 401(k) Benchmarking Survey, 2009

Stable Value update

Stable Value Market-to-book ratio’s have recovered

- Market-to-book ratios have leveled off to the 102 to 104 range
- M-to-B’s remained solid despite 3Q credit spreads selling off, due to strong U.S. Treasury rally – 5 year ~ 70 bps lower

Sophisticated investors continue to revisit Stable Value offerings[1]

- Charles Schwab - Pooled Fund closure ~ $8bn
- Hewlett-Packard - Separate Account closure ~$1.8bn

Investment contract capacity remains challenged

- Continuation of banks shrinking risk exposure or exiting business
- Insurance companies are the prominent contract issuer
- Bundled products dominant landscape
- Pooled funds remain hardest hit by capacity issues due to existence of 12 month put
- Re-insurance issuer looking to issuer first wrap contract by 1Q12
- Other potential issuers remain on the sidelines

Regulatory overhang remains

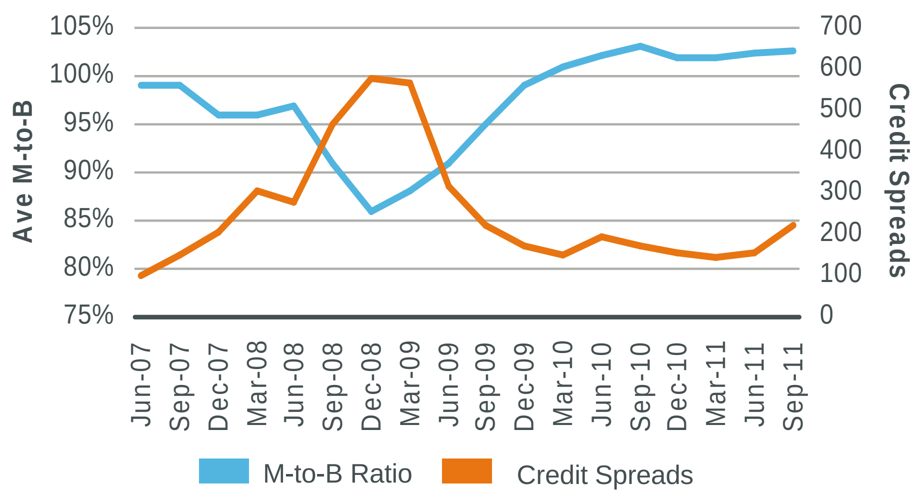
- Dodd-Frank definition of swaps remains unpublished
- Dodd-Frank Stable Value Study still in progress
- SEC & CFTC Issued 29 question survey in 3Q

Stable Value maintains positive cash inflows

- 71% of all October inflows were to SV or GICS[2]
- The average pooled fund cash balance increased from 13.5% to 15.5%[3]

1 Pension & Investing online, Money Market Directory
2 AON-Hewitt: Online – 401(k) Index Observations Over time (October)
3 Hueler Analytics Stable Value Pooled Fund Comparative Survey

Market-to-book ratio vs. credit spreads



Source: Hueler Analytics Stable Value Pooled Fund Comparative Survey, Barclays Credit Index

Average Stable Value snapshot: 09-30-11	
Market-to-book	102.7%
Crediting rate	2.85%
Duration	2.24 yrs
Portfolio yield	2.62%
Wrap fees	20 to 36 bps

Source: Hueler Analytics Stable Value Pooled Fund Comparative Survey, BlackRock

Increasing risks to plan sponsors in Stable Value

Although Stable Value is commonly viewed by plan sponsors and participants as the “safe” asset class, there are considerable risks in the current market environment

Stable Value risk trends to plan sponsors

Investment

- Fallout from the 2008 credit crisis reduced funds ability to generate return due to additional investment constraints
- Rates likely to remain low for some time, but ultimately will go higher

Counterparty

- Fewer counterparties
- Less commitment to the industry
- Bundled solutions

Contractual

- Increase “for cause” termination events for wrappers
- Increasing number of employer initiated events
- Reduced payout structure for employer initiated events

Regulatory

- Dodd-Frank
- Senate Committee on Aging Inquiry & Investigation
- Government Accountability Office Study
  - Lehman Brothers
  - Mervyns LLC

Time is right for a plan sponsor to examine the risks within stable value

III. Low Risk Alternatives

Evaluating stable value alternatives can provide significant benefits to participants

A redesigned low risk menu can allow plan sponsors to better meet their objectives and provide a more attractive set of long term retirement benefits to plan participants

Opportunities to improve plan menu

Flexibility	Economics	Understanding
Investment Options	Low Fees	Professional Management
Investment Managers	Value Add Services	Communication
Customized Funds	Inflation Protection	Education
Investment Advice	Appropriate Liquidity	Disclosure

Additional benefits accrued to plan sponsors include:

- Increase transparency
- Reduced administrative burden

Low risk menu options being actively evaluated

BlackRock has developed a strong suite of low risk options to meet the needs of plan sponsors and participants

	Traditional Low Risk Options		Alternative Low Risk Options	
	Money Market	**Bond Fund**	**FDIC Backed Cash**	**Target Term**
Description	DC Only CTF 2a7 Guidelines	1-3 G/C Index Fund	Demand deposit service connecting participants to FDIC-backed account	Fixed Maturity Bond Fund "CD Like"
Advantage	Commingling of DC assets provides competitive advantage	Limited draw down history	Competitive return with FDIC protection	Provide fixed rate of return for a targeted horizon
Disadvantage	Current yield environment	Participant adoption NAV volatility	Current yield environment	NAV volatility
Offering	Govt. CTF[1] Prime CTF[1]	CTF	In Development	Separate Account CTF[1]
Return Objective	Superior risk return profile to "sweep" funds	Replicate risk & return of the Index	Prime PLUS	Consistent with GIC rates
Fees	14 to 16 bps	6 bps[2]	20 bps	20 to 25 bps

1To be seeded
2 Subject to an additional accrual for administrative costs, including, but not limited to accounting, custody and audit fees. The amount is capped at 2 basis points (0.02%) per year.

Traditional solution:
Money Market Funds

Recommendation: DC Cash Collective Funds

Investment Strategy – Prime

- The portfolio will invest in US dollar-denominated:
  - Short-term US government & agency securities
  - Bank obligations
  - Commercial paper & repurchase agreements
  - Domestic and foreign bank obligations
  - Other short-term debt securities issued by US and foreign entities

Investment Strategy – Government

- The portfolio will invests in in US dollar-denominated:
  - US Treasury bills, notes and obligations guaranteed by the US government
  - US Agencies and instrumentalities.
  - Repurchase agreements are fully collateralized by such obligations

Why is cash an appropriate low risk menu option

- $1 NAV
- Well understood by participants

What are the draw backs of using cash as a low risk option

- Low yield environment
- Pending SEC regulation

What is the advantage of the BlackRock solution

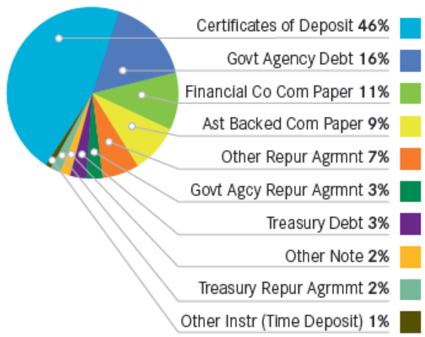
- Commingling of DC only assets is a significant competitive advantage
- First constant-dollar money market fund for institutional investors in 1973
- Demonstrated performance over 35 years of interest rate and credit cycles
- Average investment experience of portfolio management team is 18 years

% of balance transferred

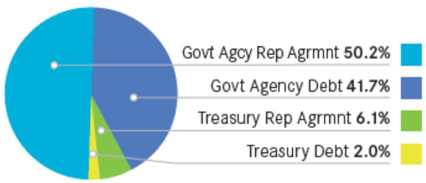
	Cash	Bond	Equity	Company stock
2005	1%	0%	0%	-1%
2006	1%	0%	1%	-2%
2007	1%	1%	0%	-2%
2008	5%	0%	-5%	0%
2009	-1%	1%	1%	-1%
2010	0%	1%	0%	-1%
Y-T-D	1%	0%	-1%	0%

Source – AON – Hewitt
Based on total balance

Prime CTF



Government CTF



Traditional solution:
Bond fund

Recommendation: 1-3 Year Government/Credit Bond Index Fund

Investment strategy

- Match the performance of the Index

Why the 1-3 year G/C is an appropriate low risk menu option?

- Four quarters of negative draw downs in the last 10 years
- Risk and Return characteristics most similar to Stable Value going forward

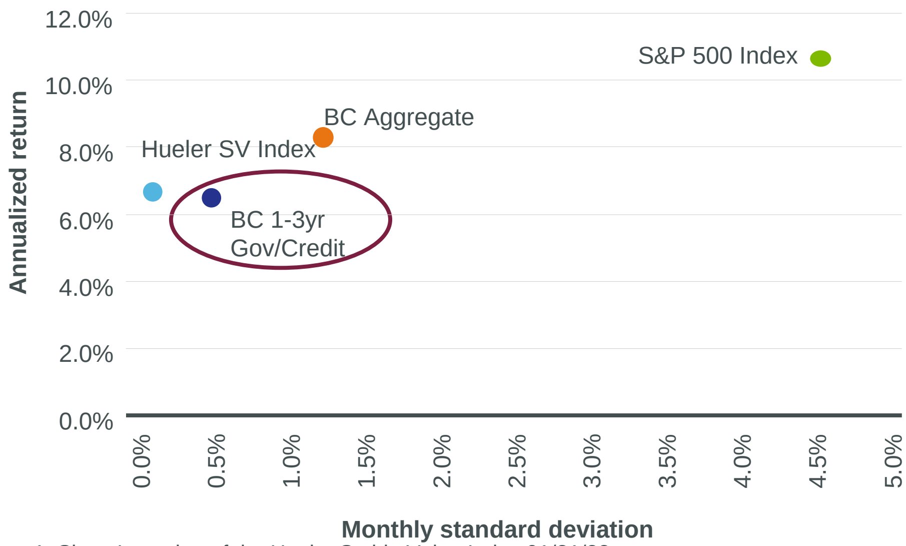
What are the draw backs of using the 1-3 G/C as a low risk option?

- Limited understanding of bond funds
- Fluctuating NAV
- Typically low adoption rates

Why have some plans adopted this strategy as their low risk option

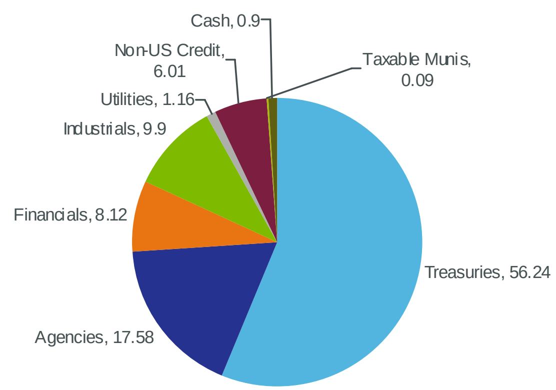
- Cost effective
- Transparent
- Strong economic case

Risk & return risk & return[1]



1. Since Inception of the Hueler Stable Value Index 01/31/83

Sector Allocation



Nominal yield: 0.72%

Alternative solution:
FDIC Backed Cash

Brokered deposit service connecting participants to an FDIC-backed account

- BlackRock is building the infrastructure needed to connect participants to an FDIC-backed account efficiently
- The service will operate similarly to existing money funds
- We will achieve this by partnering with a 3rd party infrastructure provider and banks

Credit exposure:

- Participants face deposit institution for credit
- Plan sponsors reduce fiduciary risk

Advantages to participants

- Provides a rate competitive to prime money markets while insuring loss of principal via the Federal Deposit Insurance Company (FDIC)
- FDIC coverage is provided per bank, per person, per account
- Retirement accounts are considered separate from standard deposits for FDIC coverage purposes

Advantages to bank:

- 401(k) balances tend to be stable – beneficial for bank balance sheets
- Providing FDIC product to retirement funds – a large and mostly untapped deposit market for banks
- 401(k) deposits will likely be counter-cyclical – banks will receive deposits when they are needed most

% of balance transferred

	Cash	Bond	Equity	Company stock
2005	1%	0%	0%	-1%
2006	1%	0%	1%	-2%
2007	1%	1%	0%	-2%
2008	5%	0%	-5%	0%
2009	-1%	1%	1%	-1%
2010	0%	1%	0%	-1%
Y-T-D	1%	0%	-1%	0%

Source – AON – Hewitt
Based on total balance

	Gov't money market[1]	Prime money market[1]	FDIC-backed deposits[2]
1 Year	0.05%	0.13%	0.16%
1 Year Risk	0.01%	0.03%	0.04%
3 Year	1.94%	2.28	2.29%
3 Year Risk	0.62%	0.65%	0.68%
5 Year	3.22%	3.47%	3.49%
5 Year Risk	0.68%	0.67%	0.69%
10 Year	3.00%	3.48%	3.21%
10 Year Risk	0.67%	0.67%	0.65%

1 Source: iMoneyNet Analytics as of 30 June 2010
2 Source: Bloomberg Analytics as of 30 June 2010. 3 month average yields for brokered Certificates of Deposit

Alternative solution:
Target Term Portfolio Series

Investment strategy

- A series of funds that seeks a specified return target over a given holding period
  - The return target for each fund is based on the term of the fund
  - Invests in high quality FI assets with individual maturities targeted to within 6 months to that of the fund

Why is Target Term an appropriate low risk menu option

- Term yield for a specified investment horizon
- NAV stability at some points
- Low volatility

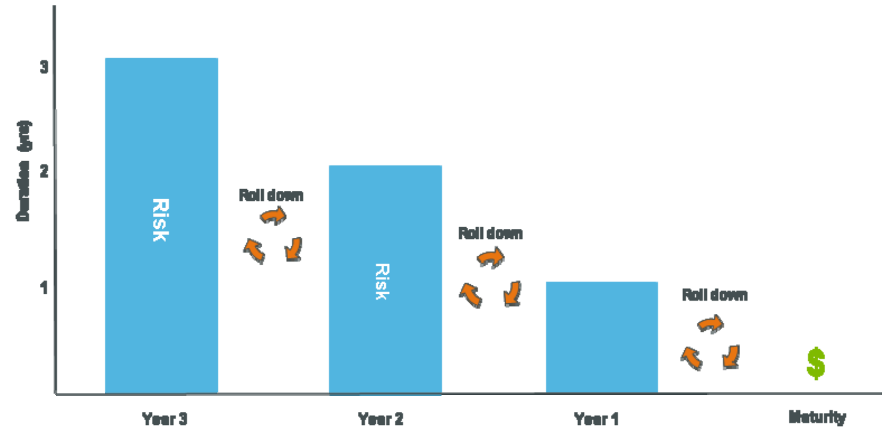
What are the draw backs of using Target Term as a low risk option

- Fluctuating NAV prior to maturity
- Education required

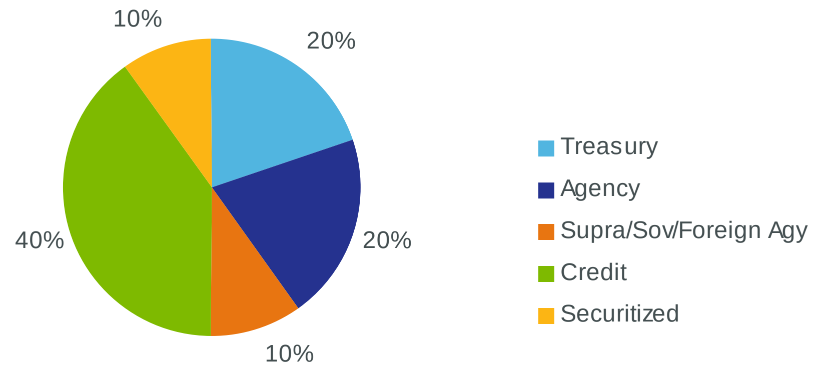
Why have some plans adopted this strategy as it's low risk option

- Easy for participants to understand
- Returns similar to stable value over time (Traditional GIC's)
- NAV certainty at maturity
- Term yield

Illustration of a 3 year target term



3 year model portfolio[1]



Estimated yield: 1.3%

1- BlackRock model portfolio - Actual portfolios may differ based on market conditions

A solution for your participant's low risk needs

Institutional plan sponsors are increasingly concerned with their low risk menu and are exploring alternatives

Product	**Money Market**	**Stable Value**	**"Evergreen" Duration Bond Fund**
Problem	Low yield	Plan sponsor flexibility	NAV volatility
Solution	Move out the yield curve	No book value wraps	Decaying duration not constant duration

Product	**BlackRock's Target Term Series**				
Term	1 Year Vintage	2 Year Vintage	3 Year Vintage	4 Year Vintage	5 Year Vintage

Details

- **Term yield for the investment horizon**
- **NAV certainty at some points**
- **Volatility decreases as the funds age**
- **Fully liquid for plans and participants**
- **Plans regain full design flexibility**
- **Fluctuating NAV if sold prior to maturity**