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Correspondence Memorandum

Date: April 16, 2019

To: Deferred Compensation Board

From: Shelly Schueller, Director
Wisconsin Deferred Compensation Program

Subject: Federated Fund: Remaining Balances After May 1, 2020

ETF recommends the Board move any balances remaining in the Federated US Government 2-5 Year Institutional Fund after the fund is closed on May 1, 2020, to the Stable Value Fund.

The Federated US Government 2-5 Year Fund has been part of the Wisconsin Deferred Compensation Program (WDC) investment lineup since 1992. Approximately 6,000 WDC participants held $31.5 million in this option as of December 31, 2018. After reviewing this fund's continued underperformance compared to peer funds, the Board voted in November 2018 (Ref. DC | 11.15.18 | 13A) to close the Federated US Government 2-5 Year Institutional Fund (Federated Fund) to WDC participants. ETF formally notified Federated of the Board's decision on November 19, 2018.

Wisconsin Administrative Code Ch. ETF 70.08 states that the investment option termination process may begin on the first business day of the sixth month following the Board's decision. Participants have six months to cease deferring to the closing fund, and another six months to move their remaining account balances from the fund. Thus, the timeline to close the Federated Fund includes notifying participants who are deferring funds to the Federated Fund as of May 1, 2019, that they must redirect existing deferrals before November 1, 2019, then further notifying any participant with a balance in the fund that they must move it to a different fund prior to May 1, 2020.

In November 2018, the Board requested that ETF review the Board's options regarding where remaining balances in the Federated Fund after May 1, 2020, could be reallocated. The Board can direct that remaining balances are reallocated to an option that is reasonably similar in terms of risk and rate of return to the option being closed. In the case of the Federated Fund, the alternatives could include the Stable Value Fund, the BlackRock US Debt Index Fund and the Vanguard Money Market Fund. If the Board takes no action, then the Board's default policy would be put into effect. This would send participants' remaining Federated balances to the Vanguard target retirement date

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

Matt Stohr Electronically Signed 5/30/19

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fund appropriate for the participant's retirement age, using age 65 as the standard retirement age.

The table below compares the Federated Fund duration, average credit quality and calendar year returns with the WDC options that are most similar in terms of risk and rate of return.

Federated and Similar Investment Options Comparison					
			Calendar Year Returns		
Option	**Avg Credit Quality**	**Duration**[1]	**2018**	**2017**	**2016**
Federated	AAA	3.6 years	0.94	0.28	2.70
BlackRock US Debt Index	AA	5.6 years	0.03	3.64	2.70
Stable Value	AA	3.0 years	2.26	1.90	1.90
Vanguard Money Market	AAA	44 days	1.80	0.79	0.25

In examining the data above, the Stable Value Fund has a very similar duration to the Federated Fund. The Stable Value Fund has outperformed the Vanguard money market fund over the past three calendar years, and returned more than the BlackRock US Debt Index fund or the Vanguard money market fund in 2018. Because duration is a bigger measure of risk than credit quality, the Stable Value Fund appears to be the most appropriate option to which any remaining balances in the Federated option after May 1, 2020, should be moved.

One concern with moving remaining Federated balances to the Stable Value Fund is that the Stable Value Fund requires a 90-day equity wash. The equity wash means that assets cannot be moved directly from the Stable Value Fund to competing investments, which are the Vanguard Money Market Fund and the FDIC-insured bank option. If balances remaining in the Federated Fund after May 1, 2020, were moved to the Stable Value Fund, and then participants moved assets out of the Stable Value Fund, these participants would not be able to move any assets into the Vanguard Money Market Fund or the FDIC-insured bank option for 90 days.

ETF believes the Stable Value Fund is appropriate, despite the equity wash concern. When the WDC has closed funds in the past, roughly half of WDC participants with a balance failed to act on their own to move their remaining balances, despite multiple notifications from the WDC. In addition, these participants do not tend to move these balances even afterward. They have left their money in the account designated by the Board. For example, the WDC still has participants with balances in the Vanguard Money Market Fund who had their funds moved to it as a result of the Board's decision to close the T. Rowe Price International Fund and the Janus Fund in 2004.

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[1] Bond duration is a way of measuring how much bond prices are likely to change if and when interest rates move. In more technical terms, bond duration is measurement of interest rate risk. Understanding bond duration can help investors determine how bonds fit in to a broader investment portfolio.

Because the Stable Value Fund is the WDC option most like the Federated Fund and expected participant inertia regarding remaining balances, ETF recommends that any balances remaining in the Federated US Government 2-5 Year Institutional Fund after it is closed on May 1, 2020 be moved to the Stable Value Fund.

ETF will develop a communication plan regarding the pending closure of the Federated Fund and participants' required actions and options. If the Board decides that the Stable Value Fund should receive Federated Fund remaining balances after May 1, 2020, the WDC will carefully explain to participants why the Board has determined remaining Federated balances should be moved to the Stable Value Fund. We intend to relay the expectation that if participants don't move their Federated balances on their own, these balances will go to the Stable Value Fund and will have the 90-day restriction.

Staff will be at the Board meeting to answer any questions.