457 News

First Quarter • April 2006 • Rod R. Blagojevich, Governor

Illinois Department of Central Management Services

Q&A

Q. If I invest in one of the new T. Rowe Price Retirement Funds, do I have to keep my money there or can I move it at a later date?

A. As with any of the investment options available in the Plan, you have the option to move your retirement savings to any of the other fund options at any time. You may make an exchange to another fund one time each calendar quarter at no charge, unlimited times after that at $10 per exchange. Please remember the excessive trader policy still applies.

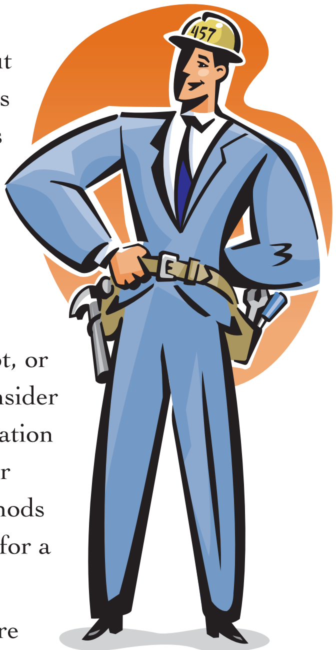
Q. Can I invest in a T. Rowe Price Retirement Fund and still choose investments from the core options?

A. Yes. You have the ability to choose the dollar amount or percent you want to invest in any of the available funds. However, the purpose of the Retirement Funds is to achieve proper and adequate diversification by simply choosing one fund: the fund with the date that matches your goal for a retirement date. The Retirement Funds assume a retirement age of 65. By combining a Retirement Fund with other Retirement Funds or other funds from the lineup, you may be defeating the purpose of investing in a Retirement Fund, which is to create a well-designed portfolio appropriate for a typical investor with your retirement date.

Q. How do the Retirement Funds invest?

A. Each T. Rowe Price Retirement Fund is made up of other T. Rowe Price mutual funds. That means you get a mix of different investments—bond and stock funds. When you are far from retirement, the fund will include more stock mutual funds to make the most of opportunities to build assets during peak savings and earning years. Later, as retirement and the fund's target date approach, the allocation becomes more conservative, emphasizing bond funds more heavily, which provide greater investment stability and income potential.

Financial Hardships—A Last Resort



It is good financial planning and budgeting to put money aside in a savings account for emergencies before you start investing in a retirement savings plan. Everyone can expect to run into a situation at some point that may require extra cash. Some of these circumstances should be budgeted for and are generally not considered a hardship. This can include auto or home payments/repairs, college tuition, credit card debt, or major appliance repairs or replacement. Also consider that taking money out of your deferred compensation for an immediate concern can seriously alter your plans for retirement. You should explore all methods to remedy your financial crisis prior to applying for a withdrawal.

Should you find yourself in a position where there are no other means to resolve your financial crisis, there is a hardship withdrawal provision for unforeseeable emergencies or loss of income. An unforeseeable emergency is defined as a circumstance for which you could have not logically planned or budgeted and you did not have significant control or failed to exercise prudent judgment. Examples of hardships that may be approved include high medical costs not covered by insurance, a disabling injury, or property damage from a natural catastrophe.

If you believe you qualify for a hardship and have no other means to resolve your crisis, contact the Deferred Compensation Division for a Hardship Application. Supporting documentation is required along with the completed application. An independent committee meets every three weeks to review each case and determine if the applicant's situation meets IRS guidelines. Those applying for hardship withdrawals are automatically suspended from participation and, if granted a hardship, will be suspended from participation for six months.

Mutual Fund Expense Ratios

All mutual funds, including those in the Deferred Compensation Plan, have annual operating costs that are indirectly paid by shareholders. These annual operating expenses are factored into a fund's price or dividend and subtracted from the share price daily. They are not charged to a shareholder's account. The higher a fund's operating expense, the more it takes away from the fund's return. Below are the total fund operating expenses for the last year compared to the average operating expense for the universe of stock and bond mutual funds.

Deferred Compensation Funds

Average operating expenses for investment options:

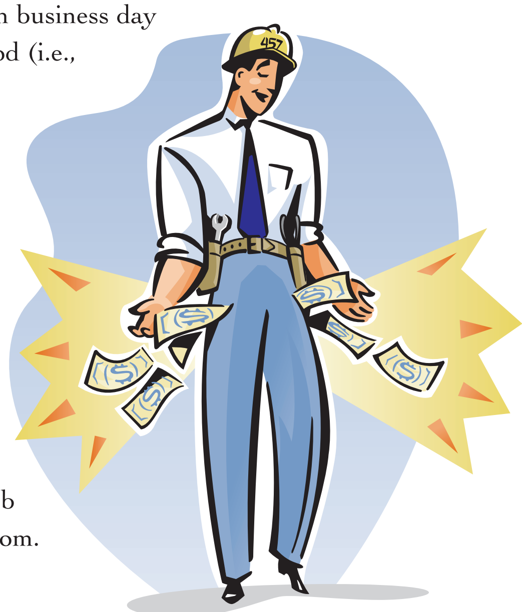
Money Market Funds	0.81%
Taxable Bond Funds	1.11%
Domestic Equity Funds	1.42%
Int'l Equity Funds	1.70%
Vanguard Prime Money Market Fund	0.09%
INVESCO Stable Return Fund	0.09%
Vanguard Total Bond Market Index	0.08%
T. Rowe Price New Income Fund	0.68%
Fidelity Puritan Fund	0.62%
Legg Mason Value Trust	1.03%
LSV Value Equity	0.69%
Vanguard Institutional Index Plus	0.03%
Wells Fargo Large Co. Growth Fund	0.95%
Columbia Acorn Fund	0.80%
Ariel Fund	1.03%
PIC Small Cap Growth Fund	1.00%
T. Rowe Price International Stock Fund	0.92%
T. Rowe Price Retirement Funds	
Retirement 2045 Fund	0.78%
Retirement 2040 Fund	0.78%
Retirement 2035 Fund	0.78%
Retirement 2030 Fund	0.78%
Retirement 2025 Fund	0.75%
Retirement 2020 Fund	0.73%
Retirement 2015 Fund	0.70%
Retirement 2010 Fund	0.66%
Retirement 2005 Fund	0.62%
Retirement Income Fund	0.56%

as of 12/31/05

Auto-Rebalancing — Keep Your Investment Strategy on Course

Over time, uneven performance between the asset classes and market volatility may throw off your selected Deferred Compensation investment allocation. Periodic rebalancing keeps your selected investment strategy consistent. The Plan's recordkeeper, T. Rowe Price, offers automatic account rebalancing for participants at no extra charge.

Auto-rebalancing maintains your asset allocation ratios according to your selection. When you request auto-rebalancing, the initial transaction occurs that day. Subsequent auto-rebalancing occurs periodically, and transactions are generated on the fourth business day before the ending period (i.e., quarter). You will get confirmation of your rebalance allocation and all subsequent rebalance exchanges that occur in your account. You can request this service by calling T. Rowe Price or accessing your account through the ***my***RetirementPlan Web site at rps.troweprice.com.



Telephone Numbers

Deferred Compensation:

Plan Rules/Options Information
800-442-1300
217-782-7006
TDD/TTY: 800-526-0844
Internet: www.state.il.us/cms/employee/defcom

Recordkeeper:

T. Rowe Price Retirement Plan Services, Inc.
Account Value Information and
Investment Changes: 888-457-5770 or
TDD/TTY: 800-521-0325
Internet Access: 800-541-3022
Internet: rps.troweprice.com

Let Your Age Be Your Investment Guide

Confused about how to spread your savings among the Deferred Compensation Plan's investment choices? Let your age help you steer your decision.

Here are two rules of thumb for how your age can be your investment guide.

- In general, the younger you are, the more you'll want to consider investing in stock funds. The reason is that over the long term (10 years or more), stocks have historically provided higher returns than bond or money market investments.
- As you grow older, you may wish to consider investing more in money market and fixed-income funds.

As you make investment decisions, measure your age in terms of decades.

Your 20s and 30s—time to start

You gain the most from a retirement savings plan if you start investing in your 20s and 30s. Even small amounts saved during your earliest working years can add up to a large sum over time. That's because of compounding—when earnings are reinvested and have the opportunity to grow along with your original investment. This is the age to consider putting a significant portion of your savings into stock funds. Retirement is a long way off, and your investments should have time to ride out ups and downs in value.

Your 40s—time to build

Even if you've put off saving for retirement until your 40s, you still have time to build your savings to a sizable sum over the next 20 or 25 years. To help your savings beat inflation, consider maintaining a large portion of your savings in stock funds.

Your 50s and 60s—time to review

Retirement is right around the corner, so you may want to reduce your exposure to risk. You may want to gradually increase your investment in money market and fixed-income funds. This may help protect your account from the short-term ups and downs of the stock market. Consider keeping a portion in stock funds—even well into retirement. This may help your savings stay ahead of inflation. Remember, your savings may need to last 20 or 30 years into retirement.

Making the investment selection

To make the process of investment selection simple, the Deferred Compensation Plan offers two different ways to invest your savings. If you don't have the time, desire, or experience to manage your own diverse investment mix, the T. Rowe Price Retirement Funds invest with target retirement dates in mind. A single investment option can offer a professionally managed, diversified mix of mutual funds that automatically adjusts for risk as your target retirement date nears (assumes a retirement age of 65 as a guideline).* If you feel comfortable in selecting your own mix, you can pick and choose between the program's 13 core investments. This flexible alternative lets you decide how much to contribute to each fund and adjust whenever you see fit.

For more information, visit the Deferred Compensation Web site at **www.state.il.us/cms/employee/defcom**.

* *There are many considerations when planning for retirement. Your retirement needs, expenses, sources of income, and available assets are some important factors for you to consider in addition to the Retirement Funds. Before investing in one of these funds, also be sure to weigh your objectives, time horizon, and risk tolerance.*

Call 1-800-457-5770 to request a prospectus, which includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing.

What does being on the "watch list" mean?

It is important that you understand what it means to be on the watch list and, perhaps more importantly, what it does not mean. Being on the watch list, as the name would imply, simply means we believe there is good reason to watch this fund more closely. Being on the watch list does not mean you should immediately sell your fund shares. It is not unusual for a fund to appear on the list from time to time. It does not mean the fund is necessarily a bad investment. If we believe the fund no longer represents a suitable investment option, we will remove the fund from the Plan.

Why are funds placed on the watch list?

Funds can be placed on the watch list for several reasons. Why a fund is on the watch list is more important than the mere fact it is on the watch list. The most typical reasons are as follows:

1. Performance—The most common reason a fund is placed on the watch list is poor performance relative to its appropriate market benchmark and/or peer group. When signs of relative underperformance appear, we place a fund on the watch list.
2. Risk—Less obvious to many participants is the risk that a fund manager incurs. If a fund becomes too volatile, we will place it on the watch list.
3. Risk-Adjusted Returns—What returns has the fund manager been able to deliver relative to the risk the fund has incurred? If the manager is unable to deliver adequate returns for the risk taken, we will place the fund on the watch list.
4. Portfolio Construction/Style Drift—Is the fund manager investing the money in the way he or she said he or she would? If you invest part of your assets in an aggressive fund that is supposed to be investing in the stock of small, growth-oriented companies, then you want the manager to do just that. We monitor the manager's portfolio, and if the security holdings do not reflect what has been communicated, we place the fund on the watch list.
5. Operations—There are many operational reasons for placing a fund on the watch list. First, the manager of the fund could leave. Remember, when you purchase shares of a mutual fund what you are really doing is hiring a professional portfolio manager to invest your money. If that manager leaves, you should watch the fund closely.

   Secondly, there could be firm-level issues. These can include issues such as regulatory violations, turnover in senior management, or a merger or acquisition. Any of these operational issues will automatically place a fund on the watch list.

The State of Illinois Deferred Compensation Plan

Current Watch List Summary

The following funds are on the watch list as of 3/31/2006:

Ariel Fund continues to underperform. It has lagged its index, the Russell 2000 Value Index, and its small value peer group for the trailing three-month, one-, three- and five-year periods. For the most recent quarter, the fund's media holdings hurt performance. In addition, the fund was hurt by the fact that high-risk stocks outperformed low-risk stocks during the quarter. Given that Ariel Fund invests in higher-quality, lower-risk companies, its performance lagged. Longer term, the fund's decision not to invest heavily in energy, utility, or technology stocks has caused the fund to underperform. John Rogers does not believe these sectors represent the most attractive investment options in the market.

Provident Investment Counsel Small Cap Growth Fund outperformed the Russell 2000 Growth Index during the first quarter but remains on the watch list due to its longer-term underperformance. The fund has underperformed its index on a one-, three- and five-year basis. For the quarter, the fund was up 14.52% versus 14.36% for its index. The fund benefited from an overweight to industrials and from strong stock selection within consumer discretionary and energy. It was hurt by weak stock selection in health care. The fund's 23% technology weighting was a slight negative for the quarter and has kept the fund's volatility slightly above average.

Wells Fargo Advantage Large Company Growth Fund was originally placed on the watch list due to its low relative returns and high volatility, and remains on the watch list due to its continued underperformance. After posting strong numbers in the last six months of 2005, the fund stumbled in the first quarter of 2006. The fund's high exposure to technology holdings, including Google, Dell, and Yahoo, hurt first quarter's performance. In addition, since smaller-cap stocks outperformed during the quarter, the fund's mega-cap focus also hurt performance. While the fund outperformed on a one-year basis, the fund remains on the watch list due to its inconsistent performance. The fund's overweight to technology has also caused the fund's volatility to be greater than average.

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