457 News
4th Quarter • January 2007 • Rod R. Blagojevich, Governor
Illinois Department of Central Management Services

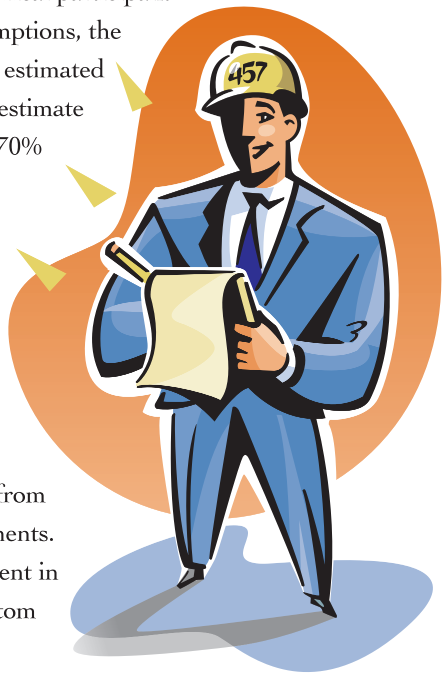
More Plan Changes?

The Illinois State Board of Investment has announced plans to release an RFP that may change the Deferred Compensation Plan's investment platform, and thereby broaden the universe of available managers. While there are no anticipated changes to fund options (managers) in the Plan at this time, as part of the Board's search for a recordkeeper, fund officials intend to ask for proposals for both the existing platform, which provides only for mutual funds, and for a new institutional structure that would also allow separate-account managers and commingled trusts. The Board plans to evaluate the two types of proposals to see whether moving to a new, broader structure offers more advantages than the existing structure.

Allowing for separate account managers and commingled trusts could provide savings to participants through lower investment management fees. However, participants would lose their ability to seek information or daily values from independent, third party investment publications. Trusts and separately managed accounts would have to be valued or "unitized" by the Plan, and all the fund information would be developed and produced by the Plan. The Invesco Stable Return Fund, currently available under the Plan, is an example of a separate account. Unlike the Stable Return Fund, the potential new funds would fluctuate in value.

The contract for recordkeeping services with T. Rowe Price will expire on December 31, 2007. The Plan has enjoyed a longstanding relationship with T. Rowe Price, and they will be encouraged to submit a proposal to continue that relationship. The Board could interview finalists and decide on which platform to use at its March meeting.

Stable Value Return for 2007



Utilizing the current rate environment, historical participant cash flows and INVESCO's modeling assumptions, the rate of return for the Stable Return Fund is estimated at a range of 4.90% – 5.20% for 2007. The estimate for the 2006 year was a range of 4.20% – 4.70% with an actual return posted of 4.79%. At the time of this newsletter, the current reinvestment rate for the fund was at 5.25%. All things being equal, the return from 2006 should continue to track toward this reinvestment rate. Factors that can heavily influence where the actual return will fall within the projected range for 2007 includes; a large net cash flow (exchanges) from the fund and a series of interest rate adjustments. Negative outflows and a downward movement in interest rates will push rates toward the bottom of the projected return.

Important Notice on the Ariel Fund

An open letter from the Director of the Illinois State Board of Investment to all participants was included with this quarterly statement mailing. Please take a moment to read this letter and the important information presented regarding the Ariel Fund and its status as an investment option in this Plan. The letter can also be found online at the Deferred Compensation's Web site at www.state.il.us/cms/employee/defcom.

Administrative Fee Reduction

The Deferred Compensation Division will institute a fee reduction in 2007 to more closely match anticipated Plan expenses. The annual charge to participants is 0.15% of account balances with a new maximum fee of $30. Last year the maximum was $35 and has been consistently reduced 12 times since the Plan's inception in 1979. In effect, participants will pay $1.50 for every $1,000 invested in Deferred Compensation Plan, up to $30 maximum, to cover administrative charges.

By state statute, the Deferred Compensation Plan must be administered so there are no expenses to the state. That is, all costs must be borne by the participants. The fees help cover such expenses as consulting projects, staff payroll, Plan materials and communications, and office costs.

Income Tax Information

Currently Deferring Participants

If you are actively deferring into the Plan, your taxable income was reduced thanks to your participation in the Deferred Compensation Plan. You will only report the wages shown in Box 1 of your W-2 statement on your income tax form. Box 1 wages have been reduced by the total amount of your 2006 deferrals and any other tax-deferred and tax-exempt deductions.

Your W-2 statement will reflect contributions to the Deferred Compensation Plan (457). The amount of your deferral is indicated in Box 12 with a G coding. Remember, you do not enter your deferred compensation anywhere on your income tax form.

For Participants on Payout

If you received a payment from your account during the 2006 tax year, you will receive a separate 1099-R mailed from our recordkeeper, T. Rowe Price, by January 31, 2006. Box 2a of your 1099-R will list the taxable amount of your distribution(s) you received during 2006 and should be entered on line 16b of your 1040 form. Box 7 of your 1099-R is the distribution code for the type of distribution received. A Code of 7 in this box indicates a normal distribution for a participant over age 59½. If you were under age 59½, Box 7 will be coded with a 2 to indicate that your 457 plan distributions are not subject to the 10% additional tax on early distributions.

For federal income tax purposes, your deferred compensation plus any earnings is taxable as retirement income when it is distributed. Deferred compensation distributions are not subject to the State of Illinois income tax. Report the distribution in the "federally taxed retirement and Social Security" subtraction section, line 5 of your Illinois return.

Facts and Figures

In 2006 the Plan received $158.4 million in deferrals. The average monthly deferral in 2006 was $380, with an average of 34,697 participants each month.

Market Value of the Plan

The market value of all investment funds as of December 31, 2006, was $2.8 billion.

Fund	Value
Stable Return Fund	$ 572,808,886
Vanguard Money Market	52,907,922
Vanguard Bond Index	50,006,298
New Income Fund	67,541,877
Puritan Fund	254,542,580
Legg Mason Value Trust	225,466,316
Vanguard Institutional Index	239,077,420
LSV Value Equity	37,384,909
Wells Fargo Large Cap	13,173,390
Acorn	1,003,486,174
Ariel Growth	131,751,783
Northern Small Cap Value	6,559,794
International Stock	108,342,336
Retirement Funds- All	82,521,586
Total	**$2,845,571,271**

T. Rowe Price Retirement Funds

Retirement 2045 Fund	$ 1,074,893
Retirement 2040 Fund	2,182,204
Retirement 2035 Fund	1,320,171
Retirement 2030 Fund	6,561,487
Retirement 2025 Fund	5,136,031
Retirement 2020 Fund	15,768,027
Retirement 2015 Fund	15,696,945
Retirement 2010 Fund	24,928,496
Retirement 2005 Fund	4,141,426
Retirement Income Fund	5,711,904
Total	**$82,521,584**

Account Values of Participants
As of 12/31/2006

Value			Participants
$1	-	$5,000	9,104
$5,001	-	$25,000	17,570
$25,001	-	$50,000	9,193
$50,001	-	$100,000	8,157
$100,001	-	$250,000	6,780
$250,001	-	$500,000	1,553
$500,001	-	$750,000	161
$750,001	-	$1,000,000	29
$1,000,001	-	$1,500,000	5

Two New Retirement Funds Added

Two new Retirement Funds were added on January 1, 2007, to offer young participants more one-step options in response to the growing demand for Retirement Funds—and to address the investment needs of participants in their early 20s—T. Rowe Price is now offering the Retirement 2050 Fund and the Retirement 2055 Fund to the investment lineup on January 1, 2007. The purpose is to include target date fund options for the younger workforce.

How the new funds fit into the Retirement Fund birth chart:

Participants born in...	May invest in...	
1988 or after	Retirement 2055	(ticker symbol TRRNX)
1983 – 1987	Retirement 2050	(ticker symbol TRRMX)

This brings the total number of Retirement Funds to 12, staggered in five-year increments. You can select the fund that is right for you by selecting the fund that most closely resembles the date in which you will retire, or by referring to a chart that bases the decision on your age. (Remember, the chart assumes a retirement age of 65 as a guideline.)

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—money market/stable value, 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.

Annual Audit

Please review your quarterly statement carefully! If it does not agree with your records, contact our auditors directly at:

Sikich Gardner & Co., LLP
1000 Churchill Road
Springfield, Illinois 62702

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

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

PlanCurrent Watch List Summary

The following funds are on the watch list as of 12/31/2006:

Ariel Fund underperformed for the quarter placing in the 80th percentile for its peer group. The fund has drifted out of the Small Value space and into the Mid Cap Blend category. The fund continues to lag dramatically for the longer term periods. The fund ranks in the 72nd percentile for Mid Cap Blend funds over the calendar year of 2006. The fund returned 10.35% for that period versus 15.26% for the Russell Midcap Index. For those participants who bought this fund for Small Value exposure the plan has added a new Small Value option, the Northern Small Cap Value Fund. The State Board of Investment has removed Ariel from the state pension plan, but decided to keep Ariel in the Deferred Compensation Plan for those participants who desire to invest in a minority owned, Illinois based firm.

Wells Fargo Advantage Large Company Growth Fund had a good quarter with a 5.6% return versus the Russell 1000 Growth Index, which posted a 5.93% gain. The fund was in line with the benchmark and in the top half of its peer group. The fund is well positioned to take advantage of a market dominated by growth, with a high weighting to technology, and eventually the market will cycle in that direction. The fund needs to put together one or two more solid quarters in a row, before being removed from the watch list.

Legg Mason Value Trust bounced back in a big way returning 9.95% for the quarter placing the fund in the top 2% of its peer group. The fund had outperformed the S&P 500 15 straight calendar years, but it is in the 99th percentile for the year, even after the big 4th quarter. This fund is highly concentrated and therefore volatile. For those wishing for a more stable large cap blend option there is the Vanguard Index fund in the plan. The good quarter notwithstanding, the fund will remain on the watch list until it puts a few more good quarters together.

T. Rowe Price International Stock had been removed from the watch list due to improved performance but the fund has struggled again this year. The fund outperformed for the quarter posting a 11.07% gain vs. the 10.40% gain posted by the international index, MSCI EAFE. The fund had been hurt this year by an overweight to Japan. Japan's future is looking brighter than it has in some time so the funds position makes sense, however it has yet to pay off. The fund's did perform slightly better than the average Foreign Large Growth Fund ranking in the 46th percentile for the quarter. We will continue to monitor this fund closely.