Indiana Deferred Compensation Plan – Hoosier S.T.A.R.T.
Report to the State Board of Finance
September 2005

Indiana Code 5-10-1.1-4(g) requires the Deferred Compensation Committee (Committee) to report to the State Board of Finance at least annually on the status of, and any changes to, the State Compensation Plan (Plan), commonly known as Hoosier S.T.A.R.T.® This report is intended to satisfy that statutory requirement.

1. **Plan Assets.**

As of June 30, 2005, the Plan's total assets were $672,637,867.20, up from $654,821,586 on December 31, 2004. Investment options and the June 30, 2005 and 2004 allocation of plan assets among them are:

Fund Name	Assets as of 6/30/05	Assets as of 6/30/04
Indiana Stable Value Fund	374,675,235	354,478,649
Alliance Bernstein Growth and Income Fund	76,351,182	71,133,919
Wells Fargo Large Company Growth Fund	47,360,465	48,349,540
Vanguard Capital Opportunity Fund	45,280,407	42,402,486
Vanguard Institutional Index Fund	24,241,572	21,738,515
Domini Social Equity Fund	18,897,423	19,012,091
PIMCO Total Return Fund	10,889,401	8,588,188
Fidelity Low-Priced Stock Fund	21,680,906	15,178,517
Indiana Moderate Life Style Portfolio	18,073,187	12,501,449
Fidelity Diversified International Fund	15,208,921	7,747,276
Great West Guaranteed Certificate Fund: 84 mo.[1]	0	974,893
Indiana Aggressive Life Style Portfolio	7,470,808	6,327,242
Indiana Conservative Life Style Portfolio	6,960,632	5,236,043
Brown Capital Management Small Co. Fund	2,667,997	3,209,382
Fidelity International Growth & Income Fund[2]	0	1,755,322
American Beacon Small Cap Value Fund[3]	3,186,279	0
TOTAL	**$672,672,485**	**$618,633,513**

[1] The Great-West CDs were an investment option offered in the plan prior to the complete revamping of the investment menu in 2002. Remaining CDs in that option matured December 31, 2004.
[2] Due to significant overlap in the underlying holdings of the Fidelity International Growth & Income Fund and the Fidelity Diversified International Fund, the International Growth & Income Fund was dropped from the investment menu and its assets mapped into the Fidelity Diversified International Fund during FY 2005.
[3] The American Beacon Advisors Small Cap Value Fund was added in response to the "hard close" of the Fidleity Low-Priced Stock Fund (barring additional contributions to that fund) in order to maintain a small cap value option for plan participants.

HOOSIER S.T.A.R.T.®
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The June 30, 2005 total assets break down between the four Hoosier S.T.A.R.T.® plans as follows:

	457 Plans (deferrals)	401(a) Plans (matching)
State Employees:	$518,163,264.55	$45,692,782.43
Local Subdivision Employees:	$108,240,225.74	$ 541,594.48

Hoosier S.T.A.R.T.® participants remain a generally conservative group of investors, with over 56% of plan assets invested in the Indiana Stable Value Fund. As of August 31, 2005, total plan assets were over $686 million.

A copy of the most recent month-end performance data for the Plan's investment options is attached to this report as Exhibit 1.

2. **Committee Composition.**

Ten people have served on the Committee since the end of the 2004 fiscal year: Mike Gery, Marilyn Schultz, Jeff Heinzmann, Betsy Burdick, Hon. Tim Berry, Mike Puro, Tom Williams, Hon. Judy Rhodes, John Lentz, and Tony Armstrong. As of June 30, 2005, the Committee members were, and remain to date:

Ryan Kitchell, Governor's appointee
Jeff Heinzmann, Auditor's appointee
Hon. Tim Berry, Treasurer's appointee
Hon. Judy Rhodes (R), Board of Finance Appointee
Tony Armstrong (D), Board of Finance Appointee.

3. **Participation.**

As of June 30, 2005, the Hoosier S.T.A.R.T.® Plan covered 30,368 participants:

State 457 plan:	25,005
State 401(a) plan:	23,534
Local 457 plan:	5,363
Local 401(a) plan:	240

The difference in the state numbers between the 457 and 401(a) plans represents inactive accounts that pre-date the establishment of the state 401(a) plan, offset by participants who have made an unforeseeable emergency withdrawal from their 457 account, but still have a 401(a) balance. Actively contributing state employee participants total 19,307. There are 227 local political subdivisions that have adopted the State's 457 Plan, and 15 of those have adopted and funded a local matching plan for their employees.

4. **Third Party Administrator**

Auditor Nass, as Administrator of the Hoosier S.T.A.R.T.® Plan, selected Great-West Retirement Services as the new third party administrator for the plan last December. The transition was planned and implemented beginning in January and took place on April 8, 2005. The transition occured with a minimum of disruption and no more than a handful of concerns or comments voiced by participants. In fact, the National Association of Defined Contribution Administrators awarded the

Hoosier S.T.A.R.T.® plan a 2005 Leadership Recognition Award for the transition and its implementation.

5. **Committee Meetings.**

The Committee meets at least quarterly to review plan activities, investment performance, and receive reports from the Administrator (Auditor of State Connie Nass), the third party administrator(Great-West Retirement Services), the Indiana Stable Value Fund manager (Delaware investment Advisors), the investment consultant (Capital Cities), and any other reports the Committee deems necessary. This year, there have been several additional meetings at which the Committee selected a new investment consultant, dealt with matters relating to the third party administrator transition, and evaluated and selected several investment options.

6. **Investment Consultant.**

This year, the Committee ended its relationship with Buck Consultants, a/k/a Mellon Consultants. Buck/Mellon had been hired to provide investment consulting services to the Plans. After almost two years and an assignment of the controlling interest in the company to another entity, the Committee terminated Buck/Mellon's contract.

Following a competitive bidding process, the investment consultant contract was awarded to the Indiana firm of Capital Cities LLC. Capital Cities immediately prepared and presented to the Committee an Investment Structure Evaluation that led to the issuance of four (4) RFPs for various investment options. At the Committee's most recent meeting on August 26, several investment option changes were decided upon by the Committee after the review and consideration of the four (4) RFPs and Capital Cities' analysis. The new investment options being added to the Hoosier S.T.A.R.T.® plan are:

A. <u>Wells Fargo Advantage Capital Growth Fund</u>: This is an Indiana managed fund, located in Indianapolis. The fund is replacing the Wells Fargo Large Company Growth Fund, which had been underperforming due in large part to a management style involving heavy positions in certain sectors of the market. This made the fund more volatile over time. Participant investments totaling over $47 million will be mapped from the old fund to the new fund.
B. <u>Janus Adviser Mid Cap Value Fund</u>: This fund is being added to the list of investment options in order to fill a perceived need in the investment option menu. This fund will balance out the mid cap growth option and help participants who so choose to better diversify their holdings. No funds will be mapped into this fund. It will simply start with a zero balance.
C. <u>Goldman Sachs CORE Small Cap Equity Fund</u>: This option represents a shift in the selections offered, as recommended by the Committee's consultant. Hoosier S.T.A.R.T.® has offered one or more small cap funds (Brown Capital Management, Fidelity Low-Priced Stock, and American Beacon Advisors) since 2002. Small cap value funds have recently tended to close to new investment because their popularity and the volume of contributions make it difficult for investment managers to maintain their stated investment style and objectives (Fidelity and American Beacon). Also, one of the funds has provided somewhat erratic performance due to heavy sector bets (Brown). In conjunction with adding the Janus Adviser Mid Cap Value Fund, the Committee decided to shift from small cap value to small cap broad (a/k/a small cap blend). This action should lead to greater

stability in investment offerings over time. The Fidelity balance ($21 million) will remain in place as that fund experienced a "hard close", meaning participants already invested in it may leave their money in it but no new money may be contributed. The Brown and American Beacon balances, totaling nearly $6 million, will be mapped to the Goldman Sachs fund.

D. Julius Baer International Equity II Group Trust: This fund is being added to enable international exposure within the Lifestyle Portfolios. The Fidelity Diversified International Fund had to be removed from the Lifestyle Portfolios last April when Fidelity refused to allow the fund to be included within those options without Hoosier S.T.A.R.T.® assessing Fidelity's redemption fees.[4] Neither the prior third party administrator nor Great-West was able to track redemption fees within the Lifestyle Portfolios. As a result the Committee needed to add another international option capable of being included in the Lifestyle Portfolios.

These changes to the investment options should be introduced to plan participants during the fourth quarter of this year.

The Committee met on September 23 to hear recommendations from Capital Cities regarding the underlying allocation of investments within the Lifestyle Portfolios and approved changes to those allocations.

On the issue of redemption fees, some other state plans dropped Fidelity funds from their investment options when the redemption fee requirement was instituted. Last November, the Committee discussed whether to keep or seek to replace funds imposing redemption fees and took no action to remove funds assessing the redemption fees. Now, Vanguard is preparing to impose redemption fees on some of its funds, too.

The hiring of Capital Cities LLC and selection of the Indiana-managed Wells Fargo Advantage Capital Growth Fund demonstrate the Committee's willingness and interest in supporting the Governor's "Buy Indiana" initiative when consistent with its fiduciary duty to the Hoosier S.T.A.R.T.® plan and its participants.

Respectfully submitted,

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Jeff Heinzmann
Secretary, Deferred Compensation Committee

[4] Redemption fees are charges assessed against individual participants for frequently trading in and out of a mutual fund. The fees are set forth in the fund prospectus. For example, a fund may charge a redemption fee of 1% of the amount traded if a participant were to transfer money out of the fund within 30 days of depositing the money in the fund. The purpose of the fees are to encourage long-term investment by participants, and to minimize the amount of liquidity a fund manager must maintain in order to maximize the manager's ability to productively invest the funds available pursuant to the fund manager's stated strategy and style.