State of Illinois Deferred Compensation Plan

Insight

Third Quarter 2015 Bruce Rauner, Governor

Introducing a new way to save for retirement in the State of Illinois Deferred Compensation Plan (DCP)—Roth contributions

Effective January 2016, the Illinois State Board of Investment will add a Roth contribution option to the DCP. Roth contributions provide a different tax advantage for your retirement savings from traditional before-tax contributions. This difference could mean more spendable income in retirement.

What are the benefits of Roth contributions?

Unlike before-tax contributions, Roth contributions are made with after-tax dollars, or money on which you've already paid taxes. The amount you contribute is included in the current income reported to the Internal Revenue Service (IRS) and on which you pay taxes. It's important to note that when you make Roth contributions, the amount of take-home pay in your paycheck will be less than when you make before-tax contributions.

The good news is that the balance of your Roth contributions and any earnings are not taxed when you take a qualified distribution.* The bottom line: You can potentially maximize your spendable income in retirement, even if it means giving up before-tax advantages now.

What should I do now?

Read the Frequently Asked Questions (FAQ) included in this newsletter, which give more detailed information about the differences between Roth contributions and your before-tax contributions. The FAQ can help you determine whether or not Roth contributions are right for you.

If you would like more information, or if you would like to make Roth contributions with your paycheck in January, visit the Central Management Services (CMS) website at **state.il.us/cms/employee/defcom** to download forms that allow you to select Roth or before-tax contributions. Or call CMS at **1-800-422-1300**.

To ensure that Roth contributions come out of your first paycheck in January, your enrollment form must be completed and submitted to CMS by November 30, 2015.

*__Roth qualified distributions:__ A qualified distribution is tax-free if taken upon the participant reaching age 59½, becoming totally disabled, or upon the participant's death **and** at least five years have passed since participant's first Roth contribution. If your distribution is not qualified, any withdrawal from your account will be partially taxable. These rules apply to Roth distributions only from employer-sponsored retirement plans. Additional plan distribution rules apply.

New Roth Plan Feature: Frequently Asked Questions

Q: What are the differences between traditional before-tax contributions and Roth contributions?

A: See the chart below for a quick comparison of the two types of contributions.

BEFORE-TAX CONTRIBUTIONS	ROTH CONTRIBUTIONS
When you contribute • Your contributions are deducted from your pay before taxes are taken out • You lower your current taxable income • Any earnings grow tax-deferred	**When you contribute** • Your contributions are made with after-tax dollars—money you've already paid taxes on • You do not lower your current taxable income • Any earnings grow tax-deferred
When you withdraw Your contributions and any earnings are taxed upon distribution	**When you withdraw** Your contributions and any associated earnings are tax-free if you take a qualified distribution

Q: What is a qualified distribution?

A: A qualified distribution is a distribution that is tax-free if taken upon the participant reaching age 59½, becoming totally disabled, or upon the participant's death **and** at least five years have passed since participant's first Roth contribution. If your distribution is not qualified, any withdrawal from your account will be partially taxable. These rules apply to Roth distributions only from employer-sponsored retirement plans. Additional DCP distribution rules may apply.

Q: Can I make traditional before-tax contributions and Roth contributions at the same time?

A: Yes. You can choose the one that's right for you—or both—as long as your combined savings do not exceed Plan or IRS limits. For 2015, the IRS limits the maximum elective deferral for any employee to $18,000.

Participants eligible for age 50+ catch-up contributions may defer up to an additional $6,000.

The special 457 catch-up is also eligible for Roth contributions. The special 457 catch-up allows you to defer unused catch-up contributions during the last three years before you reach your "normal retirement age" as defined in the Plan document. During those three years, you can defer up to twice the salary deferral amount in effect for that year, i.e., $36,000 for 2015. Contact CMS to apply for participation in the special catch-up provision.

Q: How much of my pay may I contribute in Roth contributions each year?

A: You may contribute a minimum of $10 per pay/$20 per month up to the IRS maximum contribution amount in Roth contributions. If you are eligible to make catch-up contributions, you may contribute up to the IRS limit for Roth catch-up contributions, which is $6,000 for 2015.

Q: What dollar increments can I elect?

A: Roth salary contributions may be made in any incremental amount above $10 per pay period.

Q: Are there any limitations, based on how much I earn, when making Roth contributions to the DCP?

A: Roth contributions to the DCP are subject to the same contribution limitations as traditional before-tax contributions. Please note that this limitation is different from the earnings limitation for making contributions to a Roth IRA. For more information on making contributions to a Roth IRA, including applicable earnings limitations, please see IRS Publication 590.

Q: What investment options are available for Roth contributions?

A: All of the investment options offered under the DCP can be selected by Roth participants. There are no differences in the investments offered for either type of contribution; for those Participants currently invested in the Plan, the Roth contributions will mirror the Participant's current allocation.

Q: If I would like to take a loan and I only make Roth contributions, will I be eligible to take a loan?

A: No. Loans will not be permitted from your Roth contributions. You may, however, take loans from any before-tax contributions, and Roth balances will be used in the calculation to determine how much is eligible for a loan. In that situation, if you have Roth contributions, they may increase the amount eligible for a loan from your traditional before-tax contributions.

Q: Can I take an in-service withdrawal from my Roth account?

A: No. In-service withdrawals will not be permitted from your Roth contribution account. However, you may continue to take in-service withdrawals from your prior before-tax and Roth employer contributions that have been rolled over into your DCP account.

Q: Can I take a hardship withdrawal from my Roth account?

A: Yes. Hardship withdrawals will be permitted from your Roth contribution account and will be included in the calculation to determine how much is eligible for a hardship.

Q: Will I be able to withdraw amounts in my Roth account upon termination of employment?

A: Yes. You may take a withdrawal from your Roth contribution account 30 days after termination of employment. Your Roth contributions are made after taxes are taken out of your pay. If you take a qualified distribution, the balance of your contributions and any associated earnings are distributed tax-free. A qualified distribution is a distribution that is tax-free if taken upon the participant reaching age 59½, becoming totally disabled, or upon the participant's death **and** at least five years have passed since participant's first Roth contribution. If your distribution is not qualified, any withdrawal from your account will be partially taxable. These rules apply to Roth distributions only from employer-sponsored retirement plans. Additional DCP distribution rules may apply.

Q: Am I allowed to convert my before-tax balance into Roth contributions?

A: No. Amounts that are contributed before tax cannot be converted into Roth contributions.

Q: Am I allowed to roll over Roth contributions from another Plan or IRA?

A: Roth amounts may be directly rolled over from other employer-sponsored plans, however, Roth amounts from non-employer sponsored account may not be rolled over into the DCP.

Q: Does the quarterly per-participant fee include my Roth account balance?

A: Yes, the $7.50 fee will be automatically deducted from participants' accounts, including both before-tax and Roth balances, on the last business day of each quarter and prorated across all of the investment options held in participants' accounts.[1]

Q: How do I access the Roth Comparison Calculator and the Tax-Deferred Savings Calculator?

A: Log in to the website at **rps.troweprice.com** to access the Roth Comparison Calculator and the Tax-Deferred Savings Calculator. If you prefer personal assistance, call T. Rowe Price toll-free at **1-800-922-9945**. Representatives are available during business days between 7 a.m. and 10 p.m. eastern time.

Investment fee changes

As a reminder, effective October 1, 2015, the Vanguard Institutional Index Fund and the Wellington Diversified Growth Portfolio had share class changes that resulted in lower fees for participants invested in those funds. Due to the change in share classes, the Vanguard Institutional Index Fund expense ratio was reduced from 0.04% to 0.02%, and the Wellington Diversified Growth Portfolio trustee fee moved from 0.55% to 0.43%.

As of July 1, 2015, the minimum plan-wide asset levels required to remain invested in Class E of the RATs, which has a 0.38% trustee fee, has not been met by the DCP. Therefore, also effective Thursday, October 1, 2015, the investments in RATs were transferred to Class D of the RATs, which has a 0.40% trustee fee. The 0.40% trustee fee is still a significant reduction in fees compared to fees, which ranged from 0.57% to 0.76%, that were paid by individuals investing in the T. Rowe Price Retirement Funds prior to the change in March 2015.

Keep in mind, as assets grow in the RATs, there is the potential to transfer back to the lower fee class in the future.

For more information on this change, consult the letter you recently received in the mail.

[1] Fees will not be assessed to participants' accounts having a balance (inclusive of both before-tax and Roth) of $3,000 or less.

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 DCP.

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 that 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? If you invest part of your assets in an aggressive fund that is supposed to be investing in the stocks 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. For example, 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. There could also 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.

Current Watch List as of September 2015

Wellington Diversified Growth Fund

The Wellington Diversified Growth Fund has lagged its respective benchmark, the Russell 1000 Growth, over the three- and five-year annualized periods and ranked in the bottom quartile of its peer group universe. The Fund has also lagged its benchmark over the last four consecutive calendar years. The calendar year 2011 posted the greatest under-performance versus the benchmark. The Fund did not have as much exposure to higher-priced defensive stocks, which performed best. The Fund's technology holdings also didn't keep pace with the benchmark over recent periods. Participants seeking a similar investment strategy have access to the Vanguard Institutional Index Fund, which also invests in domestic large-cap stocks.

—Prepared by Marquette Associates

TELEPHONE NUMBERS

DEFERRED COMPENSATION
Plan Rules/Options Information
800-442-1300/217-782-7006

TDD/TTY: 800-526-0844

Internet: 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**

DISTRIBUTION REMINDER

Installment payments scheduled for the month of January 2016 will be sent in the 3rd week of the month. Please note that all scheduled future installments, with the exception of January installments, will continue to be distributed on the first day business day of each month.

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