SVIA STABLE TIMES

The quarterly publication of the Stable Value Investment Association

Volume 10, Issue 4 • Fourth Quarter 2006

IN THIS ISSUE

SVIA Calls on Department of Labor to Add Stable Value as Fourth Default Investment Safe Harbor 1
Gina Mitchell, SVIA

SVIA Chair Lauds Organization as Resource for Policy Makers 1
Randy Myers

Author of *The Number:* Retirement about More than Money 1
Randy Myers

401(k) Plans Undergoing Facelift 5
Randy Myers

Country's Largest Defined Contribution Plan Embraces Lifecycle Funds with Stable Value-Like Investment 6
Randy Myers

Bank of America's Levy Sees U.S. Economy Slowing but Still Growing 7
Randy Myers

Lucas Sees "Defined Benefitization" of Defined Contribution Plans 8
Randy Myers

Fitch Sees U.S. Banks, Money Managers, Life Insurers in Strong Condition 9
Randy Myers

Bankers See Structured-Note Market Getting Busier 10
Randy Myers

SVIA Working with GASB on Synthetic GICs 10
Gina Mitchell, SVIA

Stable Value Excluded from QDIA Based on Faulty Assumptions 11
Chris Tobe, AEGON Institutional Markets

Editor's Corner 12
Greg Wilensky, Alliance Capital

Stable Value Industry Wrestles with Wrap Valuation 13
Randy Myers

DOL Attorney Says Proposed Default Investment Guidelines Don't Rule Out Stable Value 14
Randy Myers

SVIA Elects Five New Board Members 14
Gina Mitchell, SVIA

Circle Trust: A Problem Solved 15
Randy Myers

SVIA Calls on Department of Labor to Add Stable Value as Fourth Default Investment Safe Harbor

By Gina Mitchell, SVIA

SVIA called upon the Department of Labor (DOL) to add stable value as the fourth qualified default investment alternative (QDIA) in comments on the DOL's proposed regulations on default investment alternatives for defined contribution plans.

The Pension Protection Act (PPA) set the stage with a triple play to increase retirement security through auto-enrollment, auto-escalation of participants' contributions, and auto-investment. The PPA's last component, auto-investment, requires the DOL to create investment safe harbors from fiduciary liability for plans that direct investments because no investment instructions are given by participants. These investment safe harbors are called QDIAs. However, in the DOL's race to complete the play, they exclude capital preservation investments such as stable value from the three proposed QDIAs: a lifecycle or target-retirement-date fund, a balanced fund, or a managed account fund. Instead, the proposed regulations permit stable value and similar capital preservation investments only as a component of the three proposed QDIAs.

More important, by excluding capital preservation investments as a stand alone QDIA, the DOL ignores the PPA's mandate to include a capital preservation default investment. The Act charges the DOL to provide guidance on default investments "that include a mix of asset classes con-

continued on page 3

SVIA Chair Lauds Organization as Resource for Policy Makers

By Randy Myers

The regulatory environment for the stable value industry has not been particularly hospitable over the past few years. With the business and financial markets coming off a multi-year rash of scandals, accounting regulators pushed the idea that all investments should be subjected to fair-market-value accounting. The stable value industry, of course, has always relied on book- or contract-value accounting for its products, which offer investors stable principal balances and positive returns. Had regulators insisted that fair-value accounting was the only possibility, the industry might have been required to dismantle itself. Of course, that did not hap-

continued on page 2

Author of *The Number:* Retirement about More than Money

By Randy Myers

Lee Eisenberg, author and former editor-in-chief of *Esquire* magazine, may have earned his biggest taste of fame with his latest book, *The Number.* Published early this year by Free Press, the 288-page tome is all about figuring out how much money you need to retire. Most people worry that they won't have enough to live the life they want, and study after study suggests that many of them will be proven right—largely because they failed to save with enough diligence. But in an October speech at the SVIA's annual forum in Washington, D.C., in October, Eisenberg said people who think hard about what's important to them might find their finan-

continued on page 2

Chair Lauds Organization

continued from page 1

pen, something SVIA Chairman Richard Cook, manager of marketing and sales for Genworth Financials Institutional Stable Value Group, attributes as a result of the SVIA staff and membership. They worked diligently with the Financial Accounting Standards Board (FASB), he said, to explain why book-value accounting was the only appropriate standard for stable value products. Late in 2005, FASB embraced and codified that view in *FSP AAG INV-a, Reporting of Fully Benefit-Responsive Investment Contracts Held by Certain Investment Companies Subject to the AICPA Investment Company Guide on December 29, 2009.*

Opening the SVIA's annual forum in Washington, D.C., in October, Cook said the SVIA's success in preserving book-value accounting was "simply amazing" given the regulatory environment. After all, just a couple of years earlier, the Securities & Exchange Commission had effectively ruled the other way concerning stable value mutual funds, eliminating stable value funds for Individual Retirement Account investors.

Cook said the SVIA succeeded not by pounding on the table but rather by patiently meeting and communicating with regulators to explain how stable value products work. In short, the SVIA offered its staff and members as a resource to standard setters and policy makers rather than as an opponent. Since then, he notes, FASB has indicated it will use its experience with the SVIA as a model for other industry-based initiatives.

In another display of the SVIA's growing role as an industry resource, Cook said the organization provided assistance to the Boston office of the U.S. Department of Labor's Office of the Solicitor in working through the bankruptcy filing of a stable value fund in Connecticut. The fund had engaged in risky investment schemes avoided by stable value managers. (See "Circle Trust: A Problem Solved.")

All this should serve the SVIA well, Cook said, as it confronts other regulatory challenges, such as the Governmental Accounting Standards Board's (GASB) project to develop comprehensive standards for reporting on derivatives. A preliminary proposal from GASB would require that stable value funds investing in synthetic GICs report them at fair-market value rather than contract value. (See "GASB Derivatives Project Looks at Synthetic GICs," *Stable Times,* Third Quarter 2006) That would create confusion for investors and accounting headaches for stable value managers. "We are working with GASB to make sure they understand our product and to achieve another favorable outcome," Cook said.

Given the organization's recent success with FASB, that goal doesn't seem out of reach. SVIA

The Number

continued from page 1

cial needs in retirement less overwhelming than they currently imagine.

"If we examine our own lives, chances are the things that really matter fall into three categories," Eisenberg said. "I want to give something back—to my community, my church, my neighborhood, my clients. I want to fix a broken relationship. Or I really do want to try to write the Great American Novel or learn to play the piano. The dirty little secret is that those things do not cost very much." More importantly, he added, until you know what you want out of life, you can't begin to figure out just what your "number" is.

Borrowing on the work of renowned financial advisor George Kinder, Eisenberg suggests that people ask themselves three questions to help them identify their priorities. First, he says, imagine that you have all the money you ever thought you would need—a number bigger than anything you ever thought you would have. Then ask yourself what you would do with that money and how you would live. Next, assume your doctor tells you

continued on page 3

SVIA STABLE TIMES

Fourth Quarter 2006

STABLE TIMES is a benefit of SVIA membership. Published by the Stable Value Investment Association located at 1025 Connecticut Avenue, NW; Suite 1000; Washington, DC 20036; phone 202-580-7620; fax 202-580-7621; www.stablevalue.org.

Editor:

Greg Wilensky — Alliance Capital Management Corporation (greg_wilensky@acml.com)

Editorial Board:

Bret Estep — PIMCO (bret.estep@pimco.com)
Charlene Galt — MassMutual Financial Group (cgalt@massmutual.com)
Steve LeLaurin — INVESCO Institutional (steve_lelaurin@invesco.com)
Tim Murphy — New York Life Investment Management (tim_murphy@nylim.com)
Victoria Paradis — JPMorgan Asset Management (victoria.m.paradis@jpmorgan.com)
Richard Taube — Pacific Life Insurance Company (richard.taube@pacificlife.com)
Chris Tobe — AEGON Institutional Markets (ctobe@aegonusa.com)
Robert Whiteford — Bank of America (robert.whiteford@bankofamerica.com)

Historical Performance Statistics of Various Indexes

1991 through September 30, 2006

	Five Year Period			Ten Year Period			Fifteen Year Period		
Index	**Annualized Return**	**Standard Deviation**	**Correlation with S&P 500**	**Annualized Return**	**Standard Deviation**	**Correlation with S&P 500**	**Annualized Return**	**Standard Deviation**	**Correlation with S&P 500**
S&P 500	5.12%	15.52%	1.0000%	6.87%	17.44%	1.0000%	8.59%	14.81%	1.0000%
Lehman Intermediate Government Credit	4.33%	3.56%	-0.5240	5.59%	3.38%	-0.4590	6.30%	3.73%	-0.1820
DOL Cash Default Assumption	2.22%	0.64%	-0.1777	3.68%	0.87%	0.0250	3.91%	0.79%	0.1030
Stable Value1	4.81%	0.27%	-0.4060	5.59%	0.43%	-0.0140	5.92%	0.43%	0.0490

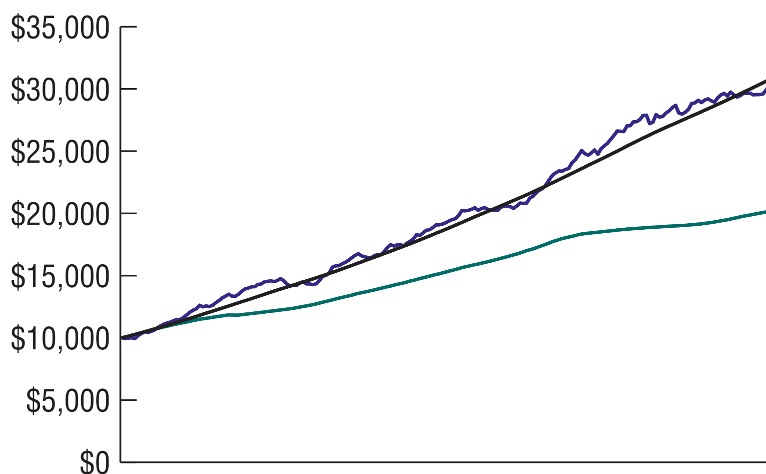
DOL Safe Harbor

continued from page 1

sistent with capital preservation or long-term capital appreciation, or a blend of both."

According to a recent Annual Survey of Profit Sharing and 401(k) Plans, 27 percent of defined contribution plans currently use stable value as a default option. The DOL's proposed regulations incorrectly assume that plan fiduciaries like those in the survey use stable value as a default because it provides the least risk and, thus, the best protection against fiduciary liability. However, the proposed regulations fail to recognize the many reasons beyond fiduciary protection for which plan fiduciaries turn to stable value as a default option.

continued on page 4



The Number

continued from page 2

have a rare and incurable disease, and while you won't suffer or feel any pain, you have no chance of living more than five or 10 years. Now ask yourself how you would live out the rest of your life. Finally, assume you go to a doctor and get the same news, except that you only have 24 hours to live. Now ask yourself what you regret not doing or not getting to be.

"Kinder will tell you that until you can get somewhat close to an answer for the last two questions that you feel solid and comfortable and even excited about, you're just doing financial planning around a void," Eisenberg told his audience. "You're just projecting acquisitions of nice things for the next 20 or 30 years."

Eisenberg is teaching an old message: Money isn't everything. SVIA

DOL Safe Harbor

continued from page 3

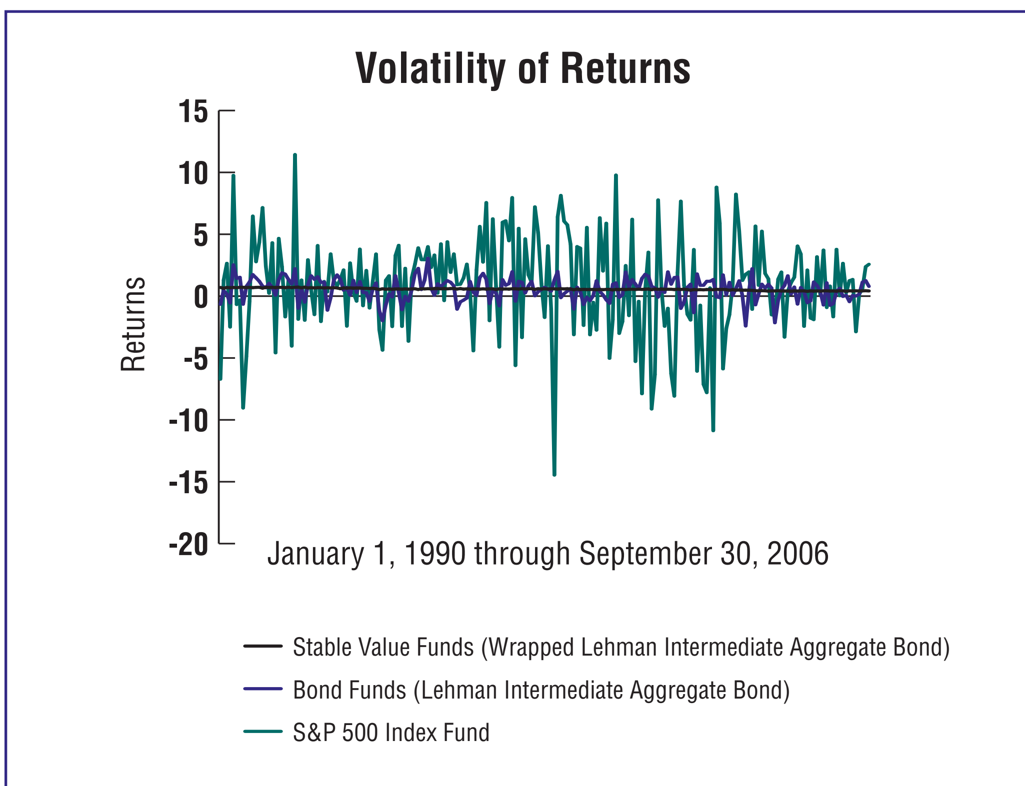
These reasons are:

- Stable value investment performance has been competitive and consistently exceeded the rate of inflation over the past 15 years, as demonstrated in the Historical Performance Table and Growth of $10,000 Chart, respectively.
- Stable value funds, including "lifecycle" or "target-retirement-date" funds and balanced funds, have less volatility than investments with equity components. Less volatility may, in fact, make stable value better able to preserve future retirement income and prevent erosion of benefits than the types of funds under the proposed QDIA definition.

The Cultural Institutions Retirement System (CIRS) brings home this preservation and performance point. As they explain in their comment letter, "Exposure to these types of investments (balanced, lifecycle or target-date funds) will improve diversification, but may not always result in better investment performance. We (CIRS) believe that defining risk in a lifecycle or target-date fund based solely on age has the potential to expose employees to volatile returns in the equity and fixed income markets when they leave one of our employers. A case in point from our experience is the short service, higher turnover rates among younger employees. Many do not stay to vest in the CIRS Pension Plan, but have a Savings Plan account balance when they leave. Such young employees are the most likely to experience a loss in age-based funds due to the high equity exposure. The short service employees appreciate the fact that they do not experience any loss of principal in their account balance. The same argument is made by older workers who come to work at one of our member institutions and do not want to risk any investment loss." This point is illustrated in the Volatility of Returns Chart.

- Stable value funds have relatively low costs compared to "lifecycle," "target-retirement-date," and balanced funds, particularly those that use a "fund of funds" structure. According to a 2004 study by IOMA, Inc., a business information firm, annual fees for stable value funds average 42 basis points, compared to 74 basis points for "lifestyle" funds that are analogous to lifecycle and target-retirement-date funds and 78 basis points for balanced funds.
- Many plan participants are risk averse, particularly those close to retirement age or who plan to spend only a short time at a given company. These participants' risk aversion may cause them to stop contributing to their 401(k) if there are losses. One of the peer reviewers of the Department's economic analysis in connection with the proposed regulation pointed out that low-income workers also may be risk averse, such that any additional expected income from lifecycle funds "may only come with an unacceptable amount of risk." It is appropriate for plan fiduciaries to choose more conservative default investments, such as stable value, based on the demographics and other facts and circumstances of their particular plan. In fact, surveys show that participants move more of their money into less volatile, more conservative investments such as stable value funds as they age.

Finally, the Department's economic analysis supporting the proposed regulations implicitly acknowledges that the principal contributor to savings is increased contributions, not higher investment performance. Research on this subject confirms that the key driver for generating retirement savings is the rate of deferral of income rather than asset allocation. As a result, fund selections that discourage increased contribution levels due to the risk aversion of participants would do more to decrease retirement savings than the choice of potentially higher-performing funds would increase such savings.



continued on page 5

401(k) Plans Undergoing Facelift

By Randy Myers

The 401(k) plan is undergoing a facelift. Twenty-five years after the Internal Revenue Service gave provisional approval to the first such retirement savings plan, financial services firms are introducing a slew of new features that, for many American workers, will make the 401(k) function a bit more like a traditional defined benefit pension plan. Among the changes: automatic enrollment strategies that extend the reach of the plans to more eligible workers, greater access to professional investment advice, and greater access to professional money managers for their plan assets. One thing that isn't changing, of course, is that participants, not their employers, will still bear primary responsibility for funding their 401(k) accounts. And they will retain the authority to direct their 401(k) investments themselves if they wish.

The newly passed Pension Protection Act of 2006, by creating fiduciary safe harbors under which plan sponsors can set up automatic enrollment programs and provide investment advice to plan participants, will hurry these changes along. Unfortunately, says attorney Randy Hardock, a partner with the law firm of Davis & Harman LLP in Washington, D.C., some of the plan sponsors will need clarification from federal agencies to take full advantage of the new law's key features may be slow in coming.

Blame politics. The new law capped a tortuous legislative process that had lawmakers fiercely at odds with each other. "This bill had more people fighting in the legislative and executive branches than I'd ever seen," Hardock told attendees at the SVIA's annual national forum in Washington, D.C., in October. "You had the White House fighting with Congressional Republicans, Republican committee chairmen fighting with the Republican leadership in the House and Senate, and committees fighting with committees." The result, he says, is that many of the players in Congress aren't in the mood to come back to the table and reopen old wounds, preferring to let the regulatory agencies, such as the Department of Labor (DOL), Treasury, and, to a lesser extent, the Pension Benefit Guaranty Corporation, figure out how to fill in the details. Unfortunately, Hardock warned, those agencies are undergoing a personnel shakeup—the DOL's Ann Combs, assistant secretary of the Employee Benefits Administration, is stepping down from her post, for example—meaning that guidance could come "in dribs and drabs."

One area where the DOL is acting fast, however, is on the question of what constitutes an acceptable default investment option for a defined contribution plan. In September, the Department issued proposed guidelines that would provide a fiduciary safe harbor for plan sponsors—assuming six conditions of implementation are met—who default their participants into three types of investments: lifecycle or "targeted-retirement-date" funds, balanced funds, or professionally managed accounts. The DOL is soliciting comments on the proposed rules and is expected to have the new regulations finalized in the first quarter of 2007.

While plan sponsors could continue to use other types of investments as default investment options under the new regulations, they wouldn't enjoy the same fiduciary safe harbor given to other plan sponsors. In prac-

continued on page 6

SAVE THE DATE!

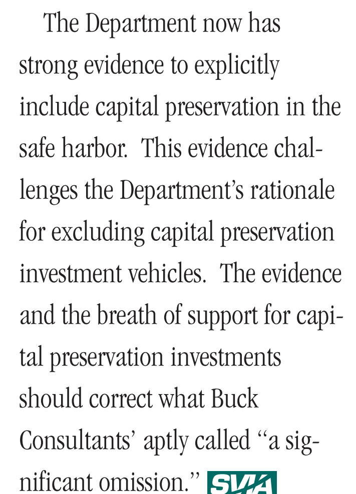
SVIA's National Forum and Membership Meeting
October 9 - 11, 2007
Fairmont Hotel, Washington, DC

DOL Safe Harbor

continued from page 4

A broad spectrum of over 80 commentors have joined the SVIA in making the case to add stable value as the fourth QDIA. The advocates for stable value as a QDIA safe harbor include plan participant representatives such as the AFL-CIO, the AFSCME, and the Pensions Right Center; plan sponsor groups such as the American Benefits Council, the ERISA-Industry Council, the Profit Sharing/401(k) Council, the National Association of Manufacturers, the Chamber of Commerce, the Employers Council on Flexible Compensation, and the Society of Human Resource Management; and providers of capital preservation investments such as the American Council of Life Insurance, the Committee of Annuity Insurers, the National Association of Variable Annuities, and SVIA. Only three commentors specifically criticized capital preservation investments and supported the Department's proposed exclusion of such investments from the safe harbor.

The Department now has strong evidence to explicitly include capital preservation in the safe harbor. This evidence challenges the Department's rationale for excluding capital preservation investment vehicles. The evidence and the breath of support for capital preservation investments should correct what Buck Consultants' aptly called "a significant omission."



Country's Largest Defined Contribution Plan Embraces Lifecycle Funds with Stable Value-Like Investment

By Randy Myers

When Gary Amelio began looking for better ways for 3.6 million federal workers to save for retirement, he didn't have to look far. He simply took the five investment options already offered by the federal government's $193 billion Thrift Savings Plan and used them as building blocks to create a series of target-date lifecycle funds. Today, less than a year and a half after their August 2005 launch, those lifecycle funds are used by 10 percent of Thrift Savings Plan participants and account for more than 7 percent of plan assets.

Amelio, who calls lifecycle funds "the greatest thing for retirement plan participants since sliced bread," is executive director of the Federal Retirement Thrift Investment Board. It oversees the Thrift Savings Plan, or TSP, a defined contribution plan operated for a wide range of federal government employees, from Capital Hill secretaries to postal workers and the military. It is the largest such plan in the country.

Speaking at the SVIA's annual forum in Washington, D.C., in October, Amelio said he favors lifecycle funds for their simplicity, diversity, and low cost. Investing exclusively in other TSP funds, their asset allocation mix is automatically revised each quarter to gradually put more emphasis on current income and less on growth. The closer the fund gets to its target date—and the closer its investors get to their retirement date—the smaller the fund's allocation to equities becomes. Participants who use the lifecycle funds pay no additional fees to do so; they pay only a pro-rata share of the cost of the underlying funds.

Those underlying funds include a stable value-like fund that invests in non-marketable U.S. Treasury securities with maturities ranging from one to four days, a bond fund that tracks the Lehman Brothers U.S. Aggregate index, a stock fund that tracks the Standard & Poor's 500 stock index, another stock fund that tracks the Dow Jones Wilshire 4500 index of small-cap and mid-cap stocks, and an international stock fund that tracks the Morgan Stanley Europe, Australasia, and Far East index. The lifecycle funds themselves number five. They include four that have target dates ranging from 2010 to 2040, plus a "current income" fund. The latter has roughly 74 percent of its assets allocated to the plan's stable value-like fund, Amelio said. The stable value-like fund is also the plan's default investment option, he said, although that could change in the future. However, making such a change would literally require an act of Congress.

Amelio said he and his staff worked with Mercer Consulting to create the asset allocation models for the lifecycle funds and with State Street Corp. to develop the communications programs and marketing materials needed to

continued on page 7

401(k) Plans Facelift

continued from page 5

tice, Hardock predicts, most sponsors will migrate to those that have been blessed by the DOL. Hardock also predicts that growing numbers of plan sponsors will adopt an automatic enrollment policy for their defined contribution plans.

In other areas, Hardock said he doesn't expect plan sponsors to stop using employer stock as an investment option in their plans. And he suspects that many sponsors who have not yet begun to make investment advice available to their plan participants will continue to hold off on that until the new law's language on that subject is clarified. The law is fuzzy, for example, in its description of the circumstances under which a financial advisor can give individualized advice to plan participants beyond that generated by a computer model. It also isn't terribly clear how audits of advice providers should be conducted.

Hardock also predicted that the traditional defined benefit pension plan is not going to become extinct anytime soon. "More defined benefit plan freezes are almost a certainty," he said, "but these things go in cycles. I think we will see to some extent a revitalization of defined benefit plans, perhaps in the form of hybrid plans. These types of plans offer advantages for many companies, especially in the small plan market."

Finally, Hardock predicted that however the November mid-term elections turn out, Congress is likely to turn its attention back to pension legislation again soon, despite having just passed the PPA. The emphasis on the next go around, he said, is likely to center on expanding the defined contribution plan system and expanding private savings in general. One issue legislators might address, he said, is the establishment of automatic distribution requirements for participants leaving defined contribution plans.

That, too, could have the makings of a good political battle. SVIA

Bank of America's Levy Sees U.S. Economy Slowing but Still Growing

By Randy Myers

Hurt by a slowing housing market, the U.S. economy grew at an anemic 1.6 percent inflation-adjusted annual rate in the third quarter, its slowest pace since 2003. But Bank of America Chief Economist Mickey Levy says that while economic growth is moderating, neither a prolonged slump nor a recession is on the horizon.

> *"The rate of economic growth is going to moderate and fall somewhat below its trend line, but will remain healthy."*

"The rate of economic growth is going to moderate and fall somewhat below its trend line, but will remain healthy," Levy told attendees at the SVIA national forum in Washington, D.C., in October. Noting that GDP has grown at an average rate of 3.4 percent annually since 1960, Levy said the key to the economy's continued health will be the U.S. consumer, who has let the country's personal consumption rate fall into negative territory only three times in the past 45 years. During that four-and-a-half-decade period, personal consumption grew at an average annual rate of 3.6 percent, slightly outpacing the overall economy. While personal consumption grew slightly less than 3.6 percent over the past year, he predicted it will not fall below about 2.5 percent to 2.75 percent in the year ahead.

In support of this view, Levy noted that personal consumption is driven most directly by trends in inflation-adjusted disposable income, a metric that has been trending higher—to above the 7 percent level—for the past four years. The recent decline in oil prices, and the downward pressure that decline has put on prices for gasoline, natural gas, and home heating oil, will provide a further boost to disposable income, Levy predicted.

Household net worth is a secondary driver of personal consumption and one impacted by trends in the real estate market, which has recently slumped. But Levy said that even if real estate prices fall by 10 to 15 percent nationally, that would put only a minor dent in household net worth.

While some forecasters worry about the nation's trade imbalance—U.S. imports are growing faster than exports—Levy is nonplussed. He attributes that trend to the fact that since 1990 the U.S. economy has been growing persistently faster than the economies in Europe or Japan, raising U.S. demand for imports. He also noted that about 40 percent of all imports are industrial supplies and capital goods used by business for production and expansion, a good indicator of a strong economy. "Just because there are trade imbalances, don't think the world is coming to an end," Levy cautioned. "You have to analyze why those imbalances exist."

Levy's benign forecast could be wrong, he warned, if consumer confidence is so jarred by the decline in housing prices that consumers reign in personal spending, or if the Federal Reserve takes too conservative a stance on interest rates—if, that is, it continues to raise rates so much that businesses stop hiring or cut back on overtime. That could raise mortgage default rates and hurt the bond market. "But the Fed is very aware of this risk, so I don't see it on the radar screen," Levy said. Also bolstering his confidence, he said, is the fact that the slowing economy and falling oil prices have both caused expectations for inflation—the bogeyman the Fed fears most—to decline. In fact, Levy said, if the economy and inflation are both growing slower next year, it could even lead the Fed to lower interest rates. SVIA

Lifecycle Funds

continued from page 6

introduce them to plan participants. He warned that smaller plan sponsors may not find it as easy to create their own lifecycle funds, especially if they offer actively managed funds and frequently change their fund lineup. Nonetheless, the federal government isn't the only plan sponsor to have created its own customized lifecycle funds, and if any more give credence to Amelio's glowing endorsement of their value, it isn't likely to be the last.

Lori Lucas, a consultant with Callan Associates who also spoke at the forum, noted that she has worked with many employers who have found it worthwhile to create their own customized lifecycle funds out of the core investment options their plans already offer. That's been especially true, she said, where the employer's core investment options are institutional investment accounts offering lower costs than retail mutual funds. Beyond cost savings, she said, benefits of building custom lifecycle funds with institutional investments include the ability to use best-of-class investment managers and the opportunity to include stable value funds and alternative investments, such as real estate investment trusts, in them. SVIA

Lucas Sees "Defined Benefitization" of Defined Contribution Plans

By Randy Myers

Everyone knows the bad news about 401(k) plans. Unlike a traditional pension plan, they don't provide any guaranteed level of income for retirees. Too many workers don't participate in them, and when they do, too few invest wisely—or at an adequate level. Yet 401(k)s and similar defined contribution plans can provide workers with a satisfactory level of retirement income if employers build the right features into them, says plan expert Lori Lucas. Increasingly, they do.

"This is one of the most interesting times in the evolution of the retirement plans," Lucas told attendees at the SVIA's annual forum in Washington, D.C., in October. "Employers are becoming quite a bit more paternalistic with respect to defined contribution plans. They're not looking to shift responsibilities to employees; in fact, they're looking to take back certain types of responsibilities. They want to help participants in defined contribution plans much the same way they once helped them with defined benefit plans. I call this trend the defined benefitization of the defined contribution plan."

> *"Employers are becoming quite a bit more paternalistic with respect to defined contribution plans. They're not looking to shift responsibilities to employees; in fact, they're looking to take back certain types of responsibilities. They want to help participants in defined contribution plans much the same way they once helped them with defined benefit plans. I call this trend the defined benefitization of the defined contribution plan."*

Lucas is senior vice president and defined contribution practice leader for Callan Associates, an investment consulting firm serving fund sponsors, investment managers, financial intermediaries, and mutual fund boards. One of the key trends making defined contribution plans more like defined benefit plans, she said, is the increased use of automatic enrollment—something that should get a boost from the recently passed Pension Protection Act (PPA), which provides some explicit fiduciary safe harbors for plan sponsors who adopt it within the Act's prescribed guidelines.

The PPA also endorses the concept of automatically increasing participant contributions, again within specified guidelines, which also should be good for plan participants. Lucas cited a recent survey by the consulting and recordkeeping firm Hewitt Associates indicating that 17 percent of plan sponsors already offer automatic deferral increases and 13 percent plan to add that feature.

Other promising trends that should make defined contribution plans more valuable to plan participants, Lucas said, include:

- offering participants greater access to premixed asset allocation funds, such as target-date lifecycle funds;
- defaulting participants who don't make investment choices into balanced or premixed funds rather than more conservative funds;
- providing participants with greater access to best-in-class investment managers rather than limiting them to a single fund company's products; and
- blending alternative asset classes into target-date funds.

Despite those positives, Lucas said plan sponsors may need to continue pushing hard in some areas to make defined contribution plans as effective as possible. For example, the PPA says employers can't automatically default more than 10 percent of a participant's salary into their retirement savings account without their consent. Capping contributions at that level isn't a great idea, Lucas says, because many workers may need to contribute at a higher rate to ensure a financially secure retirement—especially if they don't start saving early in their careers. Also, employers will have to be careful to ensure that by establishing default deferral rates lower than 10 percent—the Pension Protection Act only requires a minimum rate of 3 percent in the first year of participation—they don't unwittingly encourage some workers already contributing at higher levels to drop down to the lower "endorsed" rate.

Looking ahead, Lucas predicted that one of the next major trends in the defined contribution plan marketplace could be the introduction of guaranteed income products, along the lines of an annuity, for plan participants who have reached retirement age and want to assure themselves that they won't outlive their savings. "I don't think we have the perfect product for that out there, or that it's even that high on the radar screen of employers," Lucas said. "But I do think we'll see more of it in the years ahead, and it does kind of close the loop on the defined benefitization of the defined contribution plan. SVIA

Fitch Sees U.S. Banks, Money Managers, Life Insurers in Strong Condition

By Randy Myers

Thanks to several years of strong economic growth, low inflation, and low interest rates, the U.S. banking, asset management, and life insurance industries are all in good shape, according to analysts at international rating agency Fitch Ratings.

Banks. Kenneth Ritz, a senior director in Fitch's financial institutions group, told attendees at the SVIA's annual forum in Washington, D.C., that despite some challenges on the horizon, U.S. banks enjoy solid profitability, strong asset quality, good liquidity, and sound capital levels. Fitch's rating outlook for the industry is stable.

Ritz listed four main challenges to the banking industry's good health: limited opportunities for revenue growth, heavy reliance on consumer as opposed to business customers, a highly competitive lending environment, and an ever-changing accounting and compliance environment. Of those, he identified revenue growth as the most daunting obstacle. Banks have limited opportunities to grow organically, he said, because the compressed yield curve is limiting what they can earn on the spread between rates at which they borrow and rates at which they lend. Meanwhile, intense competition is leaving them with little pricing power. Yet growing through acquisitions is challenging, too, he said, because sellers are demanding high prices and because integrating two different institutions can be difficult. Nonetheless, Ritz said he expects merger-and-acquisition activity in the banking sector to remain strong, in part because potential sellers, driven by earnings pressures, are starting to show a little more willingness to be flexible on their selling price.

Ritz called the recent reliance by many banks on higher-margin consumer business a "concern" rather than a challenge. Consumers have been buoyed by low unemployment, low interest rates, and rising real estate prices, and while interest rates have been rising over the past year and housing prices have recently stopped climbing, Ritz said he would be more worried about consumers if the economy tanked and unemployment rates started to skyrocket—not the consensus outlook from most economists.

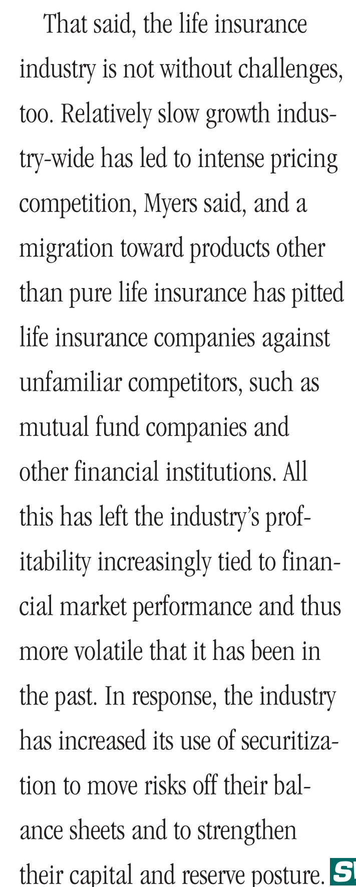
Asset Managers. Leslie Bright, also a senior director in Fitch's financial institutions group, said asset managers, such as mutual fund companies and divisions or subsidiaries of investment and commercial banks, also are in good financial shape. Fitch's credit ratings for those businesses range from a respectable BBB+ to AA-. The company's ratings outlook for all of them is stable except for one positive.

Among the factors that have been helping asset managers, Bright said, are improved equity markets and growing investor wealth. Many larger money managers enjoyed stronger profits in 2005 and the first half of 2006 versus year-earlier periods, she said, and have seen their assets under management increase as well. On the downside, she said, pretax earnings on assets under management have declined over the past five years, driven not only by increasing competition but also by increasing demands for pricing transparency. That has driven down transaction fees. The recent decision by Bank of America to offer free stock trading to customers with a specified minimum amount of money on deposit was the latest major development in that area, she said.

Looking ahead, Bright said the aging of the Baby Boomers—the 75 million or so Americans born between 1946 and 1964—will provide new opportunities for asset managers to develop new products and expand their services.

Life Insurers. Of all the industry sectors covered by Fitch Ratings, life insurers as a group are the most highly rated, said Douglas Myers, a senior manager in Fitch's insurance group. Ninety-four percent carry investment-grade credit ratings, and Fitch's outlook for the group is stable, as it has been since September 2002. What's more, after six years in which ratings downgrades exceeded ratings upgrades in the sector, that relationship was reversed in the first half of 2006, with seven upgrades and only three downgrades. The industry's strengths, Myers said, include its strong capitalization, moderate use of debt leverage; good asset quality; and stable, long-duration liability profile.

That said, the life insurance industry is not without challenges, too. Relatively slow growth industry-wide has led to intense pricing competition, Myers said, and a migration toward products other than pure life insurance has pitted life insurance companies against unfamiliar competitors, such as mutual fund companies and other financial institutions. All this has left the industry's profitability increasingly tied to financial market performance and thus more volatile that it has been in the past. In response, the industry has increased its use of securitization to move risks off their balance sheets and to strengthen their capital and reserve posture. SVIA



Bankers See Structured-Note Market Getting Busier

By Randy Myers

Activity in the structured-note market slowed significantly over the past two years as the yield curve flattened and some big corporate issuers, such as the domestic auto companies, were shut out of the retail market by their declining credit quality. However, a number of bankers told attendees at the SVIA's annual forum in Washington, D.C., that the market is showing signs of becoming more active.

Structured notes are securities featuring embedded puts or calls that cause their return to vary with changes in interest rates or some other index. Issuers have strong incentives to participate in the market when they can. Jeffrey Barany, an executive director with investment bank Morgan Stanley, where he heads the Americas Multi-Asset Class Structured Notes Group, estimated that corporate issuers will capture approximately $50 million in interest rate savings this year by issuing a projected $18 billion in structured notes.

Dave Bradley, a vice president with investment bank Bear Stearns & Co., noted that some of the slack created by the absence of domestic automakers from the retail marketplace this year was taken up by Toyota Motor Corp., which issued about $600 million in notes. Next year, he said, he expects Toyota to issue more than $1 billion in retail notes, perhaps as much as $2 billion. He also foresees insurance companies continuing to be strong players in the retail market, accounting for as much as 20 percent of new issuance next year.

Assessing the demand for structured notes, Robin Budd, senior vice president with Wachovia Securities, said investor uncertainty over the outlook for interest rates appears to be sparking new demand. When the outlook for rates is uncertain, she said, investors develop a bigger appetite for capital preservation, which structured notes can provide.

While retail investors continue to be interested predominantly in notes from brand-name sellers, Barany said institutional investors are becoming more comfortable investing in structured notes from a wide variety of issuers. Three to four years ago, he said, many were only comfortable buying notes from government-sponsored entities because they didn't want to couple credit risk with interest rate risk. Today, they're willing to buy not only from brand-name corporate issuers, but also from lesser known corporate issuers.

In general, Budd said, retail investors are less concerned about the overall size of the issue in which they are investing and more concerned that, should they want to sell before their notes mature, they will have access to a liquid secondary market. High-net-worth retail investors, she added, are starting to buy more esoteric structured notes, including commodity-linked and equity-structured notes, as opposed to plain vanilla deals. SVIA

SVIA Working with GASB on Synthetic GICs

By Gina Mitchell, SVIA

Stable value funds have been a long-standing investment in defined contribution retirement savings plans. Stable value, along with equity and company stock, comprises the core of most people's retirement savings, according to Hewitt's 401(k) Index™, with each comprising roughly 20 percent of assets. That's just the private sector. It is estimated that over $100 billion is invested in stable value by state and local employees in their defined contribution savings vehicles and by investors in 529 college savings plans.

Because stable value funds are such an important component to tax-deferred savings for retirement and education, standard-setters like the Governmental Accounting Standards Board (GASB) have agreed to take up issues affecting stable value, which may seem more like the needle in the haystack in providing accounting guidance to state and local entities on the reporting of derivatives and hedges.

As Aruna Hobbs, Vice President in the Pensions and Savings Group at AEGON Institutional Markets and SVIA Accounting Committee Chairman, explains, "GASB's preliminary views on derivatives created uncertainty on how synthetic GICs should be reported. To date, GASB is working to provide guidance on how contract value should be applied to synthetics as part of the derivatives project."

"The commitment of the GASB Board and staff has been amazing on our synthetic GIC issue. The derivatives project is probably one of the Board's largest undertakings. They have made time to listen to the Association's concerns and most importantly take on our issue while moving forward on the derivatives project," says Hobbs.

GASB has set an aggressive schedule for its guidance on derivatives and hedges, which now include synthetic GICs. The deadline for the exposure draft is March of 2007. The exposure draft will have a 90-day comment period. GASB has set a year-end 2007 deadline for not only final guidance but also implementation guidance of their new accounting standard. SVIA

Stable Value Excluded from QDIA Based on Faulty Assumptions

By Chris Tobe, CFA, AEGON Institutional Markets

As part of the massive Pension Protection Act (PPA) of 2006, many positive developments have occurred, including auto-enrollment and other features to increase defined contribution plan assets and participation. However, the Department of Labor (DOL) — in its effort to define Qualified Default Investment Alternatives (QDIA) for plan participants — has proposed recommendations beyond — and contrary to — the intent of the PPA. They have excluded stable value from the list of QDIAs, based on what we believe is faulty analysis of capital preservation safe harbors like stable value.

As proposed, the DOL permits only three safe harbors — balanced funds, lifecycle funds, and managed accounts — all with equity components. The disruption of removing stable value and other capital preservation options has led a number of organizations representing stable value plans and participants to write letters to the Department. Many feel that any equity volatility can be detrimental to some plan participants.

The exclusion of stable value came as a surprise because it reverses prior DOL guidance on Individual Retirement Account (IRA) rollovers that use principal-protected funds — such as stable value funds — as safe harbor default investments.

The DOL explains in the proposed regulations that it believes that nearly risk-free, fixed income investments would "more likely … erode benefits" than "increase them (benefits)." The DOL position is based upon faulty assumptions and runs counter to the PPA's call to provide a "capital preservation" safe harbor.

First, the assumptions regarding stable value performance offered in the DOL recommendation are not supported by the actual return patterns of stable value. The DOL's conclusions are based on its assumption that equity-based products provide a return that is 6.7 percentage points higher than short-term, low-risk investments. This contradicts its own peer review of the data, which suggests a differential of around 2 percentage points.

The DOL stretches back to 1926 to get equity return assumptions of 10.40 percent, while the return data over the past 15 years (a time frame more relevant with the advent of stable value and the creation and growth of 401(k) plans) from the S&P 500 Index suggests an assumption of 8.59 percent. And instead of comparing equity returns to stable value returns (which, according to the Hueler Stable Value Pooled Fund Index, have averaged 5.92 percent over the past 15 years), the DOL uses the 78-year average of Treasury bills at 3.70 percent. The DOL's apples-to-oranges comparison yields a 6.70 percentage point differential, compared to a difference of 2.67 percentage points when comparing the S&P to the Hueler Index over the past 15 years.

Second, the DOL's conclusions also seem to discount the needs and behaviors of risk-averse participants. One of the DOL's peer reviewers pointed out that low-income workers also may be risk-averse, such that any additional expected income from lifecycle funds "may only come with an unacceptable amount of risk." Stable value is a superior default option in many cases, particularly for those close to retirement age or who plan to spend only a short time at a given company and do not want to risk losing capital in the short term because of volatility in the equity markets.

The DOL acknowledges that the principal contributor to savings is increased contributions, not higher investment performance. Since default fund selections with equities still produce negative quarters — and, as a result, could actually lower participation for some risk-averse participants — one outcome of equity-only QDIAs is to negate any potential for outperformance to grow balances. In fact, over the 15-year time period referenced above in comparing stable value returns to equity returns, a typical 70 percent equity/30 percent fixed income balanced fund portfolio would have delivered 18 quarters with negative returns, compared to zero for stable value funds.

"They have excluded stable value from the list of QDIAs, based on what we believe is faulty analysis of capital preservation safe harbors like stable value."

Third, stable value funds also have relatively low costs when compared to lifecycle, target-retirement-date, and balanced funds, particularly those that use a "fund of funds" structure. According to a 2004 study by IOMA, Inc., annual fees for stable value pooled funds average 42 basis points, compared to 74 basis points for lifestyle funds and 78 basis points for balanced funds.

continued on page 12

Faulty Assumptions

continued from page 11

Finally, though the DOL states that the proposal should not be construed to indicate that the use of other types of investment alternatives not covered by the regulation (such as stable value products) would be imprudent, the likely effect will be to shift plans away from stable value as default investments to give themselves a clearer safe harbor with a QDIA. This would push plans to offer higher-risk and higher-fee default options for their participants.

This proposal has already had real effects on plans. Wyatt Watson reports that in a survey of Insider plan sponsor subscribers, 94 percent currently have a default investment fund; 47 percent expect to leave the assets that are currently invested in the default investment fund in the same fund; 27 percent will consider changing their default investment fund; 13 percent have not decided what they will do; and 3 percent expect to transfer to one of the new proposed default investment funds. Clearly, the proposed guidance has encouraged a rethinking of capital preservation investments for default investments.

Groups representing plans like the Profit Sharing / 401k Council of America (PSCA), the U.S. Chamber of Commerce, the National Association of Manufacturers, the Employers Council on Flexible Compensation, and the ERISA Industry Committee have called for guaranteed products to be added as a fourth QDIA. Plan participant groups such as the American Federation of State, County and Municipal Employees, the AFL-CIO, the Cultural Institutions Retirement System, and the Pension Rights Center have supported adding a capital-preservation option. Industry groups such as SVIA, the American Benefits Council, and the American Council of Life Insurers have also written the DOL seeking to amend its proposals regarding the QDIAs. And companies such as Diversified Investment Advisors, Metropolitan Life Insurance Company, John Hancock Financial Services, Mass Mutual Financial Group, AEGON Institutional Markets, Prudential Financial, Transamerica Retirement Services, and Dwight Asset Management have appealed to the DOL to revise its proposals to include stable value.

There is no reason to exclude stable value funds from the safe harbor. It is consistent with the PPA and in the best interests of participants to add stable value as a fourth QDIA, which in turn will give the decision about the appropriateness of using stable value to plan sponsors They are in the best position to make this judgment for their plans' participants. SVIA

Editor's Corner

By Greg Wilensky, Alliance Capital

While it is hard for me to believe, 2007 is just around the corner. Our days are now filled with traditional year-end events. Another Thanksgiving spent with family and friends gorging on turkey and watching football has passed, and I am trying to coordinate all the traditional holiday and school events planned for December. (The traditional winter concert at my sons' elementary school is coming up. Now that I have a good set of ear plugs, I am even looking forward to hear the band and orchestra perform.)

Continuing another time honored tradition, our final issue of the *Stable Times* for the year will highlight the action from the SVIA fall conference. We have again enlisted the valuable assistance of free-lance journalist Randy Myers to chronicle the conference proceedings. Consistent with a conference that was packed with topical information for the stable value and retirement-saving industries, this *Stable Times* offers a selection of topics to rival the desert selection at the typical Thanksgiving feast.

As I reflect on the issues facing our industry over the last year, I am also struck by something that has been a non-issue. 2006 brought a dramatic continuation of the flattening trend for the U.S. yield curve. The spread between 5-year Treasuries and cash has compressed by almost 200 basis points in the last two years and now is more than 50 basis points inverted. Money market yields now rival stable value returns after a long period of trailing significantly behind. Even with these shifts and reasonably strong equity markets, participants continue to be pleased with the performance of their stable value funds. Cash flow activity for stable value funds has been quite muted. Given the accounting and regulatory-induced challenges that we have been facing, this stability is certainly something for which we can all be thankful.

As 2006 comes to a close, the *Stable Times* Editorial Board would like to take this opportunity to express its gratitude to the people who have written or solicited writers for our publication this year. Furthermore, we would like to thank SVIA's Gina Mitchell and Gwen Collick, our graphic artist Ellen Cornett, and grammar and style editor David Lampo for their tireless work on the *Stable Times*. Finally, we would like to wish all our readers a safe, happy, and healthy New Year.

Stable Value Industry Wrestles with Wrap Valuation

By Randy Myers

Under new accounting guidelines adopted last year by the Financial Accounting Standards Board (FASB), stable value funds can continue to rely on contract-value accounting as long as benefit-responsive requirements are met. However, FASB changed stable value funds' presentation and disclosures in financial statements. Funds are now required to report the fair value of all assets including investment contracts—including wrap contracts . To do that, stable value sponsors must assign a fair value to the wraps.

As described in the Second Quarter 2006 issue of *Stable Times* (see "Stable Value Managers Embrace New Guidelines Affirming Book-Value Accounting), an SVIA task force has been working to recommend a valuation approach for wrap contracts.

At the SVIA's annual forum in Washington, D.C., in October, Laura Powers, a director with BlackRock, reviewed the three valuation methods prescribed by FASB.

Powers characterized the three methods evaluated as the income approach, the market approach, and the cost approach. The income approach includes converting future cash flows to a single present value or using option-pricing models. However, when the SVIA task force asked three wrap providers to calculate the value of a wrap contract for a sample portfolio using option-pricing models, Powers said, the resulting valuations ranged from $12,000 to $2.5 million, demonstrating that it suffers from "a clear lack of consistency."

The market approach considers observable market prices for comparable assets and liabilities, which in the case of wrap contracts do not exist. One variation on this technique—matrix pricing—would involve characterizing and grouping wrap contracts by common factors. Wrap providers would then price each group, and their assessments would be used as the basis for valuing individual contracts. This would require cooperation between different wrap providers in the industry, which could require some convincing. For example, of 10 wrap providers questioned by the task force, Powers said, three indicated they wouldn't participate in such an effort. Their response, she theorized, wasn't so much an indication that they didn't want to work with their industry colleagues but rather a concern about the difficulty and practicality of such an approach.

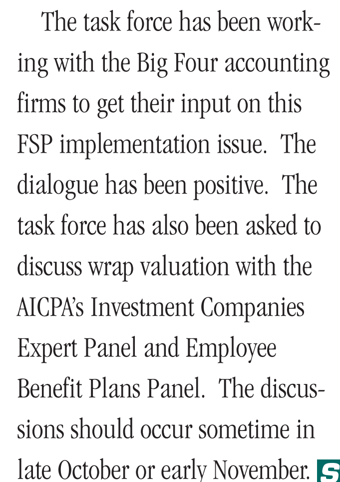
The cost approach calculates the value of a wrap contract by looking at what it would cost to purchase a replacement contract. The challenge, Powers conceded, would be to get a wrap provider to price a competitor's product, which she said would not be practical. Therefore, existing wrap providers will be required to provide a "replacement cost" of the contract, given current risk characteristics of the stable value fund.

> *"The fair value of the wrap contract would be the difference between its present value of the replacement cost at the reporting date and the present value of the actual wrap fee."*

Ultimately, Powers said, the task force may recommend a valuation approach that combines different aspects of the three methodologies, particularly the cost and income approaches. For example, the fund manager might use the cost approach to determine the current value of a wrap contract by getting a bid to replace it from a wrap provider. Then, it could use the income approach to determine the present value of the fee payments related to the contract. The fair value of the wrap contract would be the difference between its present value of the replacement cost at the reporting date and the present value of the actual wrap fee.

Fund managers and plan sponsors who use these products will need to settle on a methodology soon. They are required to disclose the value of their investment contracts in their annual reports for plan years ending after December 15, 2006. Powers encouraged them to work closely with their auditors to make sure they are familiar with what's being done. She also suggested that fund managers encourage their auditors to work closely with their colleagues at the national level so that the same auditing firm isn't endorsing different solutions in different parts of the country.

The task force has been working with the Big Four accounting firms to get their input on this FSP implementation issue. The dialogue has been positive. The task force has also been asked to discuss wrap valuation with the AICPA's Investment Companies Expert Panel and Employee Benefit Plans Panel. The discussions should occur sometime in late October or early November.



DOL Attorney Says Proposed Default Investment Guidelines Don't Rule Out Stable Value

By Randy Myers

Despite excluding stable value as one of the permitted qualified default investment alternatives, a Department of Labor (DOL) attorney told attendees at the SVIA's annual forum in Washington, D.C., that the proposed new guidelines for choosing default investment options don't preclude employers from picking a stable value fund, or any other investment option, if they wish.

The guidelines—developed by the DOL in keeping with the recently passed Pension Protection Act of 2006—list just three types of "qualified default investment alternatives" for investors in defined contribution plans who don't select their own investments. They are lifecycle or target-date funds, balanced funds, and professionally managed accounts. If an employer defaults plan participants into one of those three options, the guidelines say, the employer can't be held liable for the performance of the investment, provided, as always, that it was prudently selected and monitored. However, the proposed regulations don't actually prohibit plan sponsors from defaulting participants into other options, such as stable value funds, if they wish. Nor do they imply that doing so would be irresponsible.

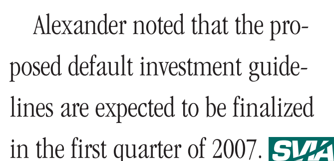
"What we've made clear is that there's nothing per se imprudent about a fiduciary using other investments that may not be described (in the guidelines)," said Lisa Alexander, a pension law specialist with the Office of Regulations and Interpretations in the DOL's Employee Benefits Security Administration. "For instance, stable value funds may be perfectly prudent for the participants and fiduciaries of a given plan, and our regulation is not saying the qualified default investment alternatives (QDIAs) are the only ones that can be used. Others may be perfectly prudent." The only caveat, of course, is that using something other than the DOL's qualified alternatives would not provide the fiduciary safe harbor from investment performance.

The issue of what constitutes an appropriate default investment option for 401(k)s and other defined contribution plans has become a subject of great interest to employers over the past few years as increasing numbers of them have begun to enroll employees into their plans automatically. When they do that, the chance of having participants in their plan who didn't make their own investment decisions goes up.

"For instance, stable value funds may be perfectly prudent for the participants and fiduciaries of a given plan, and our regulation is not saying the qualified default investment alternatives (QDIAs) are the only ones that can be used. Others may be perfectly prudent."

The Pension Protection Act endorses automatic enrollment and, under the default investment guidelines proposed by the DOL, provides employers with the first fiduciary safe harbor for investment performance that doesn't rely on having plan participants choose their own investments.

Alexander noted that the proposed default investment guidelines are expected to be finalized in the first quarter of 2007. SVIA



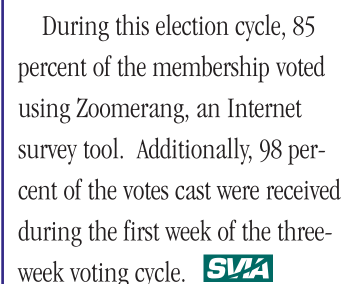
SVIA Elects Five New Board Members

By Gina Mitchell, SVIA

This fall SVIA's members elected five people to the Association's Board of Directors for a three-year term starting in 2007. They are:

- Ed Adams, IBM as a plan sponsor member;
- Karen Chong-Wulff, DuPont as a plan sponsor member;
- Brian Murphy, AEGON Institutional as a provider member;
- Laura Powers, BlackRock as a provider member; and
- Richard Taube, Pacific Life as a provider member.

During this election cycle, 85 percent of the membership voted using Zoomerang, an Internet survey tool. Additionally, 98 percent of the votes cast were received during the first week of the three-week voting cycle. SVIA



WE'VE MOVED!

Effective May 30, 2006 our new address is:
Stable Value Investment Association
1025 Connecticut Avenue, NW, Suite 1000
Washington, DC 20036
Phone: 202-580-7620
Fax: 202-580-7621

Circle Trust: A Problem Solved

By Randy Myers

Stable value funds are among the most sound and secure investments available to investors in 401(k) plans and other defined contribution plans. The funds invest principally in high-quality, intermediate-term bonds that are further protected by a wrap or investment contract issued by an insurance company or financial institution. Those contracts are designed to insure that investors in stable value funds will lose neither principal nor accrued interest.

"According to the Department of Labor, the entities controlling Trust Advisors Stable Value Plus Fund, including the fund's financial advisor, Trust Advisors LLC, breached their fiduciary duties by choosing imprudent investments not appropriate for a stable value fund, paying prohibited fees to interested parties, and self-dealing with plan assets."

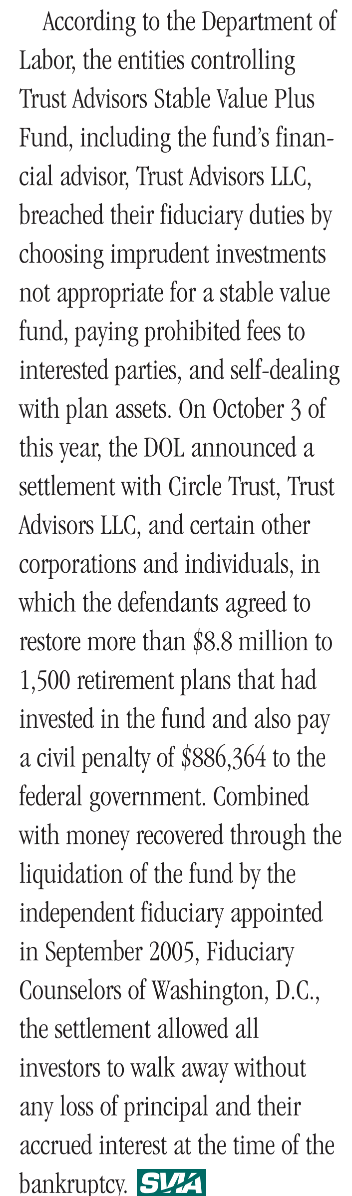
With that said, how did a stable value fund find itself in bankruptcy and charged with violating ERISA by investing in imprudent and speculative investments by the Department of Labor (DOL)?

Beginning in 1998, the Trust Advisors Stable Value Plus Fund strayed from the fund's investment guidelines, ultimately driving the fund into bankruptcy court last year. That's the bad news. The good news? Thanks to the intervention of the Connecticut Department of Banking, the U.S. Department of Labor, and an independent third-party fiduciary, Fiduciary Counselors, the fund was shut down and the stable value promise of principal and accrued interest through the bankruptcy date was kept to investors.

The fund was established in 1998 pursuant to a declaration of trust by a Connecticut bank, Columbus Circle Trust Co., which was later renamed Circle Trust Co. In time, more than 1,500 retirement plans had more than $200 million invested in the fund. For a while, it posted exceptional returns. But by 2005, losses on inappropriate investments had driven the fund's crediting rate so low that investors became concerned and regulatory authorities began to investigate its operations.

While regulators discovered that the bulk of the assets in the fund—about 75 percent of the total—were invested in a legitimate stable value fund operated by another financial institution, the remaining 25 percent of assets were steered into three investments that most stable value managers would not use in any amount. Addressing the SVIA's annual forum in Washington, D.C., in October, attorney Michael Felsen, counsel for ERISA in the Department of Labor's Office of the Solicitor in Boston, said those investments should have raised any number of red flags to anyone running a stable value fund. The questionable investments included:

- A hedge fund that invested in collateralized mortgage obligations and used inverse floaters to try to manage risk. It boasted of returns of 12 percent to 18 percent, which Felsen said "should have raised red flags all over the place." It also warned that investors could lose some or all of their money and had vague investment guidelines that allowed the general partner to change investment strategy at any time.
- An investment company engaged in the sub-prime mortgage lending business that claimed a 17 percent return on a "safe" investment. It did not have a wrap contract, meaning it was not in compliance with accounting regulations for stable value funds. It was not liquid and, again, contrary to the tenets of stable value investing, was not benefit responsive, meaning it was not obliged to pay benefits at book value.
- Notes linked to an investment fund invested primarily in other hedge funds, which in turn invested primarily in stocks. These notes also were not wrapped, were not liquid, and were not benefit responsive.



According to the Department of Labor, the entities controlling Trust Advisors Stable Value Plus Fund, including the fund's financial advisor, Trust Advisors LLC, breached their fiduciary duties by choosing imprudent investments not appropriate for a stable value fund, paying prohibited fees to interested parties, and self-dealing with plan assets. On October 3 of this year, the DOL announced a settlement with Circle Trust, Trust Advisors LLC, and certain other corporations and individuals, in which the defendants agreed to restore more than $8.8 million to 1,500 retirement plans that had invested in the fund and also pay a civil penalty of $886,364 to the federal government. Combined with money recovered through the liquidation of the fund by the independent fiduciary appointed in September 2005, Fiduciary Counselors of Washington, D.C., the settlement allowed all investors to walk away without any loss of principal and their accrued interest at the time of the bankruptcy. SVIA

SVIA's Second Spring Seminar

Evaluating 401(k)s: How Demographics, Savings, Plan Design, and Investment Choice Are Shaping Retirement Security

April 15-17, 2007
Charleston Place Hotel
Charleston, SC