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Nation at Financial Crossroads, Says Former U.S. Comptroller David Walker

By Randy Myers

For years, former U.S. Comptroller General David Walker warned that the United States was on a collision course with catastrophe if it failed to rein in its free-spending ways. Today, with the economy veering toward recession and financial markets in turmoil, Walker judges the United States to be at a "tactical crossroads" that will require "dramatic operational and policy reforms" if it wants to regain its former vigor.

"The American dream is to a great extent based on the concept of leaving things better off for our children and grandchildren," said Walker in kicking off the Stable Value Investment Association's 2008 annual Fall Forum in Washington, D.C., in October. "That dream is at risk."

Now president and CEO of the Peter G. Peterson Foundation, Walker ticked off a familiar litany of troubles that threaten the country's economic and national security, from a seemingly out-of-control spending by the federal government and citizenry alike to the country's increasing reliance on foreign nations to fund that spending. "Today our federal debt is approaching 70 percent of our gross domestic product," Walker said. "The all time high was 122 percent during World War II, but we were betting the ranch then, and we owed it to ourselves, not foreign lenders."

While the $56 trillion federal deficit (the figure if one includes the Social Security and Medicare programs) is worrisome, Walker said the real danger lies not in where the deficit is today but where it's headed. He noted that 62 percent of the federal budget is on auto-pilot, largely in the form of entitlement programs and servicing of the federal debt, and it is

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Directors' Contributions Recognized

SVIA recognized the contributions of four directors who resigned from the Association's Board at the Fall Forum and Annual National Membership Meeting in October. They are Richard Cook, Ralph Egizi, Dylan Tyson, and Vicky Paradis.

Prudential's Dylan Tyson served one term on the Board of Directors. His responsibilities at Prudential Financial have taken him away from stable value funds. While the Association wishes Dylan much success in his new responsibilities, his contributions will be missed. Dylan was a key architect of the Association's *Managing Stable Value Funds' Key Investment Principles* and *A Closer Look at Stable Value Funds Performance: An Executive Summary.*

Eastman Chemical's Ralph Egizi completed two terms on the Board. As a plan sponsor representative, Ralph shared his perspective on how stable value serves a diverse group of 401(k) plan participants to help meet their retirement savings and income goals. Ralph also chaired the Association's Government Relations Committee through a variety of issues such as the grandfathering of stable value

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Stable Value Wrap Providers Rise to Challenges of Credit Crunch

By Randy Myers

The stable value industry has not been immune to the nation's credit crunch, but it has absorbed the shock better than many other sectors of Wall Street. Despite some pullback in the number of providers willing to underwrite new stable value business, stable value managers are continuing to meet the demands of stable value investors.

Still, as financial services firms reassess the risks they face, they are making adjustments to their underwriting and pricing practices. And stable value wrap contracts—the contracts that assure a stable value fund's principal and accumulated interest, their crediting rates, and the ability of their investors to initiate withdrawals and transfers at book value—are among the items they're throwing under a microscope. In some cases, this has led to new limits on the amount of business insurers are willing to take on. For example, in a June 30 survey of 12 wrap providers, the Stable Value Investment Association found that six had stopped writing new

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increasingly squeezing out what's left for discretionary spending. Unfortunately, Walker added, Americans aren't any thriftier than their political leaders, saving far too little of their income and jeopardizing the availability of capital to invest in growing the country's businesses and, when necessary, finance legitimate government spending. "We're charging up the national credit card, mortgaging our future, and expecting our kids and grandkids to foot the bill," he lamented.

Walker pointed to four principal culprits for the current economic crisis, which traces its roots to the bursting of the housing bubble and the subsequent implosion of the sub-prime mortgage market. First, he said, there was a disconnect between those who were originating mortgages and those who would suffer losses if they failed. There also was a lack of transparency about how the financial instruments being created by the mortgage market actually functioned. At the same time, the broader financial markets were using excessive leverage, with an inadequate focus on cash flow, and, in the case of the mortgage market, an over-reliance on the value of credit ratings of mortgage securities. Finally, he said, there was a widespread failure of corporate and government risk-management functions. "We saw a failure to take action to intervene in light of clear warning signals that I and many others talked about over the years until there was a crisis," Walker asserted.

Walker went so far as to recount the decline of the Roman Empire in framing the country's dire straits. The Roman Empire fell, he said, due to declining moral values, an overconfident and extended military, a fiscally irresponsible federal government, and an inability to protect its borders. "We need to learn from history," he insisted.

Rather than continue to deny its precarious position, Walker said, the United States and its citizens must start taking steps now to deal with its fiscal crisis. He suggested beginning with better leadership at the top. He said he supports the notion of creating a bipartisan commission to make recommendations to the next president and Congress on four issues:

- statutory budget controls,
- comprehensive Social Security reform,
- tax reform,
- healthcare reform.

The recommendations on tax reform, he said, should identify which Bush tax cuts should be extended and which should not, what to do with the Alternative Minimum Tax, and what to do with the corporate tax structure to foster global competitiveness. Healthcare reform, he said, must look at what can be done to reduce what we are now spending. "If anything could bankrupt America," he cautioned, "it's healthcare costs. We are the only country that writes a blank check for healthcare."

With a new approach to fiscal stewardship, Walker suggested, the United States can right itself. He predicted that the Social Security system's solvency will be assured relatively easily by reducing the rate at which middle- and upper-income taxpayers are paid and by increasing the wage-based cap on Social Security taxes. The bigger challenge, he said, will be fixing the healthcare system, including the burgeoning cost of operating the Medicare system. He suggested that the government review its policy of allowing pharmaceutical companies to advertise prescription drugs and better target the subsidies it offers now for Medicare Part B, which is medical insurance, and Part D, which provides prescription drug coverage and benefits the wealthy more than the poor.

Credit Crunch Challenge

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business and seven had imposed limits on the total size of their business.

Presenting the results of the survey at the SVIA's 2008 Fall Forum in October, Robert Whiteford, a managing director in the Global Structured Products Group of Bank of America, said wrap providers aren't reassessing just the amount of new business they're willing to do

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Credit Crunch Challenge

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but also the investment guidelines of the stable value funds they do insure. "Some of these guidelines are rather porous," he said. "In a low-risk environment, that was acceptable. But we've found that sometimes that's where the risks are." One consequence of that finding, he said, is that insurers are asking fund managers to be more open about how they are managing their investment portfolios.

Most managers appear to be complying. "Transparency is the word," said Paula Novick, associate director and general counsel for Galliard Capital Management, an investment manager whose product lineup includes stable value funds. "If a wrap provider tells us their risk managers have an issue they're concerned about, we want to know what the issue is and what we need to provide to them." That sort of cooperation, Novick said, is helping Galliard overcome any capacity issues in the wrap marketplace. She also said that regardless of how broad the investment guidelines might be for her firm's stable value funds, it is actually managing them quite conservatively. "We are managing our portfolios much the way we always have," she said, "but we are sharing more information about that and being more transparent."

David Starr, who oversees client relationships for Dwight Asset Management Co., said his firm's stable value managers have done a number of things to compensate for the tightening of the wrap market, including holding additional cash in some of their portfolios and looking into the purchase of traditional Guaranteed Investment Contracts (GICs) to supplement their wrapped bond portfolios. "We're also considering exploring separate account arrangements with insurers," he said, "and encouraging new participants to come into the wrap market."

Dwight apparently is not the only fund manager looking to GICs. Richard Cook, manager of marketing and sales for the Institutional Markets Group at Genworth Financial, said sales of traditional GICs were up during the first half of 2008, although he warned that even that sector of the stable value market will need to see some stability in the broader credit markets soon if it is going to remain healthy.

Starr and Whiteford both predicted that pricing for wrap contracts will be going up in response to current market conditions. "The risk environment has changed, and I think it's perfectly reasonable that the fees do as well," Starr said. Whiteford, when asked by one Forum participant whether pricing could climb as high as 12 or 13 basis points, responded that he could see it going "a lot higher." Historically, wrap fees were about 8 basis points.

Attorney Steve Kolocotronis, vice president and associate general counsel for Fidelity Investment's stable value and fixed income businesses, encouraged companies engaged in the stable value business to work together to make sure that it pulls through the credit crisis in good shape. While acknowledging that some investment guidelines may be too porous, he warned against making guidelines so restrictive that all managers are "pushed into the same box."

"We could see a point where there is no real differentiation in how managers manage, which I don't think serves plans sponsors very well," Kolocotronis said. "Some plans can take more risk than others due to the stability of the sponsoring company or other individual variables. I hope wrap providers will understand that, and that when we work our way out of this and capacity opens up, managers will be allowed to manage the way they want, within reason, but maybe with more price differentiation in terms of what they pay for their wrap contracts."

"It's important to remember that we're going through unprecedented times," added Laura Powers, managing director and a portfolio manager for Blackrock Investment Management. "None of us would be here discussing this issue if not for the state of the financial markets. I think we're going to have to be creative in dealing with the issues we have today and potentially look at ways to restructure portfolios or find new ways to protect the wrap providers. But we all have a common goal. We just need to be patient and hang in there. It will get better." SVIA

Directors' Contributions

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funds as an investment default, the Department of Labor's qualified default investment alternatives, and 401(k) fee disclosure requirements.

JPMorgan Investment Management's Vicky Paradis also left the Board after serving two terms. Vicky has chaired the Communications and Education Committee and led the Association's Media Team. Much of her work culminates in the newspaper and magazine headlines SVIA has received. She also served on the editorial board of *Stable Times* since its inception and is a past chairman of the Board of Directors. Known for her quantitative abilities, Vicky was one of the main proponents of performance measurement for stable value funds and the fee template for stable value funds.

Genworth Financial's Richard Cook is retiring effective December 31. Rick is the immediate past chairman of the Board and is currently serving as the Board's secretary. He has also served as the Board's treasurer. A lawyer by training, Rick has made many contributions to SVIA. A major contribution in today's Sarbanes-Oxley environment was to ensure that the Association was in compliance with the new law in terms of all of its governing documents. As SVIA chairman, he launched the first definitive study of stable value as an asset class by Wharton/CRAI. The study documented the characteristics and benefits of stable value and found that stable value should be the fixed income component of a well-diversified 401(k) portfolio. The study also found that stable value could be used to create an annuity-like income stream for retirees who stay in employers' 401(k) plans. SVIA

Editor's Corner
Providing Stability in Systemic Change

By Gina Mitchell, SVIA

This issue of *Stable Times* highlights many of the presentations from the October Fall Forum and Annual National Membership Meeting. Having organized the past 10 of these events, I have worked with the Planning Committee to try to predict what will be informative and timely. Each year this task seems harder. However, during this year's systemic market change, we seemed to bring together the leading authorities on the major issues affecting the financial markets. We had an oil expert, leading economists, and the Freddie and Fannie Mae regulator and TARP principal there, as you will read in this issue. Their insights are relevant as we work through this new market cycle.

You'll see that stable value funds have also been affected by the new market cycle. However, stable value continues to post positive, steady returns. In fact, stable value funds tend to be one of the few asset classes that is not posting losses. Maybe now policymakers and financial theorists will appreciate the more durable and dependable qualities of stable value such as capital preservation and conservative and steady positive returns when developing and evaluating retirement policy. Clearly, stable value has a role in 401(k) asset allocation, as many 401(k) plan participants will tell you.

However, experts tend to brush aside stable value's characteristics, based on the belief that equities will outperform stable value over the long term. While that may be generally true, averages obscure the variability of returns and the devastation that a prolonged or deep market drop can have. For many who have just lost 39 percent of their 401(k) balances, they know. Unfortunately, they may not have the time or the income necessary to rebuild their 401(k) accounts.

That's why it is important for both the experts and 401(k) participants to focus on what investors can control. 401(k) investors have no control over the variability of returns, but they do have control over three factors: the amount they save, the time they save, and how they invest (or their asset allocation).

Stable value clearly has a role in a well-diversified 401(k) portfolio. Stable value performs in all market cycles even when other assets do not. It is a powerful tool for 401(k) investors. And, we have seen 401(k) participants recognize stable value's characteristics and use it to achieve their retirement income goals. Depending on the length of the current downturn of the financial markets, even the policy and financial experts may become advocates.

Supreme Court Rulings Give Additional Support to Plaintiffs in Benefit Cases

By Randy Myers

A pair of recent Supreme Court decisions will make it easier for people to sue their current or former employers in connection with their benefits plans, according to a leading benefits attorney. Nell Hennessy, president and CEO for investment advisor Fiduciary Counselers Inc. suggests the real-world implications should not be terribly dire.

In *LaRue v. DeWolff, Boberg & Associates,* James LaRue argued that his employer's failure to carry out his instructions to make changes to the investments in his 401(k) plan caused his account to suffer a $150,000 loss. When the U.S. Supreme Court ruled in February that LaRue had the right to pursue his claim, it seemed to contradict established case law. For two decades, drawing on a U.S. Supreme Court ruling in *Massachusetts Mutual Life Insurance Co. v. Russell,* U.S. courts had held that individuals cannot sue their retirement savings plan for a breach of fiduciary duty unless that breach created losses for the entire plan. LaRue was suing only to recover his own losses. In affirming his right to sue, the high court said that with 401(k)s and similar defined contribution plans now the most common type of employer-sponsored retirement plan, such lawsuits should be permissible.

Importantly, the decision didn't find LaRue's employer at fault but merely said the case should be heard by a lower court. And as Hennessy told participants at the SVIA's 2008 Fall Forum in Washington, D.C., a concurring opinion by Chief Justice John Roberts threw an additional wrinkle into the court's finding. Roberts said that when a trial court rehears the LaRue case, it should determine whether LaRue's suit was actually a claim under Paragraph 502(a)(1)(B) of the Employee Retirement Income Security Act. If so, LaRue could be compelled to exhaust all possible administrative remedies before filing suit. Applied universally, Roberts' requirement would make it more difficult for individuals to successfully sue their retirement plans, notwithstanding the court's ruling in LaRue. In fact, Hennessy noted that in a subsequent case decided in July—*Lanfear v. Home Depot Inc.*—the 11th U.S. Circuit Court of Appeals ruled that the plaintiff would indeed have to exhaust all possible administrative relief before it could pursue its lawsuit.

In another closely watched case, *Metropolitan Life Insurance v. Glenn,* the Supreme Court affirmed a 1989 decision which held that employers and insurers who function as both the administrator of a health benefits plan and a payer of claims have an inherent conflict of interest. But it expanded the original decision by declaring that in employee benefits lawsuits, courts must consider this conflict of interest along with other factors pertinent to the case and not toss lawsuits out on the conflict issue

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Stable Value Continues to Play an Important Role in 401(k) Plans

By Randy Myers

In the contest to capture assets in retirement savings plans, the stable value industry is holding its own—even as increasing numbers of plan participants opt to put at least some of their money in target-date funds.

In some cases, the continued strength of stable value funds is a tribute to investor allegiance to the value proposition they offer, including the ability to deliver bond-like returns coupled with the low volatility of money market funds and guarantees of principal and accumulated interest. At the Cultural Institutions Retirement System (CIRS), most of the 9,900 active plan participants, who are museum and daycare workers, rely heavily on stable value in the three retirement savings plans that provide coverage for 375 cultural organizations. Only about a tenth of the active participants don't put any money into stable value.

Speaking at the Stable Value Investment Association's 2008 Fall Forum in Washington, D.C., Robert Fox, executive director of the CIRS, said that like other plan sponsors, his organization has been fielding a lot of phone calls this year from plan participants worried about the safety of their money. Upon hearing where their accounts stand, he said, "those in stable value feel a lot better."

So deeply does CIRS believe in stable value that it has bucked conventional wisdom and designated its stable value fund as the default investment option for plan participants who don't make an investment choice of their own. Since November 2007, when the Department of Labor issued a fiduciary safeguard for plans that adopt target-date funds as their default option, most employers have chosen them as their default. Fox said his organization was comfortable with its decision.

Elsewhere, employers who appreciate the benefits of stable value funds have begun to incorporate them into their target-date funds. John Fischer, director of institutional investment products for insurance company Mutual of Omaha, said his firm offers both risk-based asset allocation funds and target-date asset allocation funds in the plans that it operates for its clients. It includes allocations to stable value in the most conservative funds of both types. "About 50 percent of our full-service 401(k) customers are now using these funds," he reported. "Overall, I would say they have been very successful and well used."

International Business Machines Corp. manages its own 401(k) plan and is among the growing number of plan sponsors who offer target-date funds that include a stable value component. Its 10 target-date funds invest in varying proportions in the plan's eight core funds, one of which is a stable value fund. The plan also offers four risk-based asset allocation funds and incorporates stable value in all but the most aggressive. In the most conservative risk-based fund, 35 percent of the assets are allocated to stable value.

Edward Adams, manager of defined contribution strategy and implementation for IBM Retirement Funds, said that overall, IBM has about $8 billion, or 25 percent, of its plan's assets in stable value, including about $800 million within the target-date and risk-based funds. Current contribution rates to stable value are slightly lower, he added, with about 14 percent of participants' ongoing contributions going into that asset class.

IBM just introduced its target-date funds at the end of 2007, at which time it also closed its money market fund and transferred assets from that fund into the stable value fund. Through the first nine months of 2008, Adams said, about 8 percent of the plan's participants had allocated some money to the target-date funds, with about 5 percent of future contributions earmarked for those funds. In total, he said, they represent about 1 percent of the plan's assets.

Ralph Egizi, director of benefits finance and investments for

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Supreme Court Rulings

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alone. "If a district court is sympathetic to a plaintiff and wants to overcome the initial denial of a claim, it will now be able to couch their decision based on the facts of the case," Hennessy said. "This decision allows courts that want to favor a plaintiff to leave a door open to them."

That said, Hennessy noted that many insurance companies still include so-called "discretionary clauses" in their group benefits contracts, giving them the right to decide when an insured has a legitimate claim. Such clauses are banned in some states for some types of insurance contracts, including California, Illinois, Maine, Minnesota, New York, and Oregon but are still allowed in many others. "If the insurer is the decision maker, it won't be able to rely on *Metropolitan Life Insurance v. Glenn,*" Hennessy said. "If, however, it is acting as an Administrative Services Only (ASO) provider, or has some similar third-party administrative role and is not offering an insurance product, it will be able to take advantage of the MetLife decision, assuming the plan has this discretionary language. The defense bar views this as very favorable."

Hennessy advised benefit plan fiduciaries to recognize that the United States now has a well-financed plaintiffs bar that is focused on ERISA lawsuits, something that did not exist prior to the accounting-scandal collapse of Enron Corp. in 2001. "These plaintiffs firms are continuing to bring cases, including employer stock cases and others relating to 401(k) plans," she warned, "including cases centered on issues such as disclosure of revenue-sharing arrangements and excessive administrative fees." In the wake of the current economic crisis and the devastating impact it has had on retirement plan balances, Hennessy said she expected a crop of new cases next year.

Department of Labor Plans Additional Guidance on Retirement Plan Fee Disclosures

By Randy Myers

Mindful that a new administration will soon be taking office, the Department of Labor's Employee Benefits Security Administration (EBSA) is pushing to publish by year-end additional guidance for retirement plan fiduciaries who are charged with giving plan participants information about their plan's costs and investment options.

In July, EBSA proposed requiring fiduciaries to provide plan participants with summary information, including fee and expense information, about the investment options available in their plans, either in a comparative chart or similar format. "We got over 90 comments on this proposed regulation, and we are working through them," Robert Doyle, director of EBSA's Office of Regulations and Interpretations, told the Stable Value Investment Association's 2008 Fall Forum in Washington, D.C., in October. "We hope to have a final regulation out by year-end."

Doyle said the EBSA also is pushing to complete regulations pertaining to the offering of investment advice to retirement plan participants, as required by the Pension Protection Act (PPA) of 2006. Prior to passage of the PPA, firms providing mutual funds and other investment options to retirement plan participants couldn't also give investment advice to those participants without running afoul of prohibited transaction rules spelled out in the Employee Retirement Income Security Act, or ERISA. The PPA created statutory exemptions that allows them to do so, provided the advice comes from a computer model or the investment firm charges the same fees for all of its products, thereby eliminating any incentive for itself to steer participants to one investment option over another. The Department of Labor (DOL) was charged with implementing the new law.

In August, the DOL published two proposed rules relating to this issue. Unfortunately, Doyle said, deciding how to apply the fee-leveling exemption proved trickier than the legislators who crafted the PPA might have imagined. In interpretive guidance issued in 2007, the ESBA said the new statutory exemption would apply to fiduciary advisors and their employees but not to affiliates of the advisor. Subsequently, it heard from some financial services firms that to receive the intended protections, they were having to restructure their operations—not what the government had envisioned. Doyle said the ESBA also struggled with implementing the fiduciary exemption for computer-generated advice. For example, he said, the way the statute was framed, if a plan participant asked a financial advisor a follow-up question after getting computer-generated advice, the financial advisor wouldn't receive a regulatory exemption in offering follow-up advice. These matters are addressed in the proposed new rule, Doyle said, and the ESBA wanted to hold a public hearing on its proposal before finalizing it.

Asked about DOL's decision in late 2007 to allow stable value funds to qualify as Qualified Default Investment Alternatives (QDIAs) in defined contribution plans only on a grandfathered or short-term basis, Doyle told Forum participants he thought it was too soon to revisit that issue, even though stable value funds have fared far better in the recent financial market turmoil than many investments that did qualify as QDIAs.

SVIA Elects Four New Board Members

SVIA members elected four new directors to the Association's Board of Directors. They are:

- Tony Camp, ING, who was elected to a second term,
- Jordan Culp, DuPont,
- Terry Finan, Jackson National Life,
- Steve LeLaurin, INVESCO Institutional.

The four service firm directors were elected by 77 percent of the membership. All directors serve three-year terms. Their terms begin on January 1, 2009 and conclude on December 31, 2011.

Stable Value's Important Role in 401(k) Plans

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Eastman Chemical Co., suggested that for some retirement plan participants, having access to a stable value fund may be one of the reasons they stay in their plan, even after they retire—as many do at his company. "Part of it may be the culture of Eastman Chemical," he said. "We're located in a small company town. But I think there's also a recognition that they can't really get stable value outside of the plan, and many people want to keep that investment; they like it. The only people who tend to roll their balances over are those who leave the company before they retire."

IBM's Adams said his company, too, has a lot of retired employees in its plan, adding, "I think a lot of that has to do with having access to stable value and to our low fees."

Federal Regulator Sees Lower Mortgage Rates as Key to Fannie-Freddie Revival

By Randy Myers

Restoring the health of the nation's housing market and the two federally supported mortgage buyers that are its financial backbone—Fannie Mae and Freddie Mac—depends to a large degree on mortgage rates going down. But as James Lockhart, director of the Federal Housing Finance Agency (FHFA), recently conceded, the extraordinary measures the federal government has taken to shore up the U.S. financial system, including Congressional passage of a $700 billion bailout bill, haven't yet been able to make that happen.

In early November, rates on 30-year, fixed-rate mortgages were averaging about 6.5 percent, according to the *Wall Street Journal,* while five-year U.S. Treasury notes were yielding about 2.8 percent. That is a spread of 370 basis points, up from less than 150 basis points in July 2007—a gloomy indicator of the mortgage market's health. The higher the spread, the more risky investors assess mortgage lending to be. "We need to get that spread down," Lockhart told participants at the SVIA's 2008 Fall Forum in October, "and we need to get mortgage rates down to provide stability in the marketplace."

As has been widely reported, the FHFA put Fannie Mae and Freddie Mac into conservatorship in early September in a bid to ensure the financial viability of the two government-sponsored enterprises (GSEs), whose thin capital structures had become dangerously weak following the collapse of the housing market. At about that same time, the U.S. Treasury announced that it would be willing to invest up to $100 billion each in the two GSEs in exchange for senior preferred stock. With this additional backing by the federal government, it was hoped, investors would be more willing to purchase mortgage-backed securities from Fannie and Freddie, giving them additional freedom to buy and resell still more mortgages and thereby help to drive down mortgage rates. So far, it hasn't happened.

Stretching for a silver lining to the bad news that has dominated the housing and mortgage markets for the past year, Lockhart observed that the decline in housing prices over that period has made housing more affordable for those who are able to secure mortgages. As of August, he reported, the National Association of Realtors' U.S. Composite Housing Affordability Index stood at 123.3. It increased to 135.2 in September. A value of 100 indicates that a typical family has exactly enough income to qualify for a mortgage on a typical home; the higher the number, the easier it is for them to afford that mortgage. In 2006, the index stood at just 106.1. "At some point," Lockhart said, "we'll see people who have been holding off on purchasing a home becoming new buyers and injecting liquidity into the market."

Lockhart also argued that the government's various initiatives to shore up the balance sheets of Fannie Mae and Freddie Mac mean that the federal government is providing clear support for their securities, making them more palatable to investors, which ultimately should help to restore Fannie's and Freddie's financial health. SVIA

Stable Value Assets Continue to Grow as Stocks Tumble

By Randy Myers

Stable value funds appear to be weathering the financial crisis well, judging by the experience of one manager of defined contribution plans, the U.S. arm of Dutch financial services firm ING Group N.V.

Speaking at the Stable Value Investment Association's 2008 Fall Forum in Washington, D.C., in early October, Anthony Camp, vice president of ING's Stable Value Product Group, said stable value assets in the defined contribution plans of ING clients have continued to rise moderately this year even as variable assets—primarily stock and bond funds—have declined. Similarly, data compiled by the research and consulting organization LIMRA show a sharp increase since the third quarter of 2007 in new and renewal sales of stable value products at 21 companies that market stable value investments. "We're on track to have our biggest year ever in terms of contributions to stable value," Camp said.

All this would appear to indicate that once stock prices started tumbling at the end of last year, investors began to appreciate more than ever the investment and withdrawal guarantees offered by stable value funds. Or, as Camp put it, "Not one dollar of the $2 trillion reported to have been lost in retirement savings plans this year was in stable value funds."

The numbers cited by Camp also align with data compiled by Hewitt Associates LLC. Stable value assets, including Guaranteed Investment Contracts, accounted for 27.2 percent of the total assets in the Hewitt 401(k) Index at the end of September, up from 20.2 percent a year earlier. The index tracks the daily asset transfer activity of nearly 1.5 million 401(k) plan participants at large U.S. companies. SVIA

Expert Sees Potential Crisis in Oil Derivatives Market

By Randy Myers

Americans gasped as the U.S. stock market lost nearly 40 percent of its value this year but mostly cheered when oil prices tumbled by more than 50 percent in just four months. Unfortunately, that dramatic volatility in the energy markets may be a harbinger of more tumultuous times to come. According to an energy and risk-management expert, the oil industry is in the midst of a transformation that could send still more tremors through the already shaky global economy. What's more, he warns, common prescriptions for relieving the nation's dependence on foreign oil—think drill, baby, drill—won't have the impact their proponents imagine, for a variety of reasons.

"We have an entirely different oil market than we had even a few years ago, and it's not because of changes in traditional factors such as supply and demand or the ability to sustain production," Kent Moors, executive managing partner of Risk Management Associates International LLP, told participants in the Stable Value Investment Association's 2008 Fall Forum in Washington, D.C., in October. Rather, he said, the oil market is different because of its rapid embrace of increasingly exotic energy-linked financial contracts that often have only a tenuous link to the value of oil itself. "These days, you can sometimes only dimly see the underlying asset," he warned, adding that with the recent pricing volatility, those contracts have become "a major explosion just waiting to happen. If you think the current credit crunch is the worst we're going to see, wait until we see a similar crunch in the energy futures market." Already, he noted, two U.S.-based oil-trading companies have failed because they couldn't meet margin calls.

Moors, who also serves as president of ASIDA Inc., an international consulting firm specializing in Russian, Caspian, and other developing-market hydrocarbon and financial strategies, has concluded that the world has, at best, 30 years left in which it will be able to sustain an economy based on crude oil, meaning, he said, that we must embark on alternative energy strategies sooner rather than later. While critics of current U.S. energy policy blame the government for preventing more oil and gas drilling, Moors said the actual problem is that even known oil reserves are in many cases too expensive to exploit. Even at the height of the oil market this summer, for example, when crude prices topped $140 a barrel, Moors said hundreds of orphan wells were being capped in Texas because it was too expensive to reopen them. In Russia, he added, oil leases in Siberia can be had for as little as 5 cents a barrel but are not being tapped because the lack of roads and power there make the infrastructure expenditures necessary to support exploration "staggering."

Moors noted that, according to the International Energy Agency, the top 10 producers of crude oil worldwide replaced only 74 percent of the extractable reserves they took out of the ground over the past three years. While the oil producers themselves claim higher replacement rates, he countered that "a fair amount of what they replaced it with is not commercially viable to develop."

In fact, finding new sources of crude has become difficult, too, Moors said. "In 18 years, through 2004, we spent more than $300 billion worldwide looking for elephant fields—those capable of yielding a billion metric tons, or 7.33 billion barrels, of oil," he said. "We found 16 in the first 15 years, and only two since then, and there's nowhere else to look."

During a recent visit to Saudi Arabia, Moors told his audience, his hosts took him to a new, medium-sized oil field just to demonstrate that they have plenty of crude. "This field had 30 oil derricks, and I realized that 18 of them were injection wells, meaning less than half of those derricks were taking oil out of the ground," Moors said. "The others were pushing water into the ground to maintain pressure. You don't do that unless you're having real problems with your wells, because it can jeopardize long-term production. To maintain production, the Saudis appear to be damaging their wells from the very beginning."

In Russia, Moors said, oil production has recently started to decline, due largely to high production costs. Back in the United States, he added, it would be possible to drill for oil in the Arctic National Wildlife Refuge, or ANWR, but even then, he said, it could take eight years to find out if we can actually recover any oil. He noted that two decades ago, about 63 miles northwest of ANWR in Mukluk, British Petroleum came up with the most expensive, deepest dry hole ever drilled. While technology has improved over the past 20 years, he noted, there's still no guarantee ANWR would yield any crude.

Besides, he said, even if ANWR holds all the oil that experts think it holds, and we start drilling for it today, "by the time it comes online in 2020, it will allow us to decrease our reliance on foreign oil from 70 percent to 67 percent. It won't solve anything."

Moors identified two important consequences of the problems the world is having finding and extracting crude from new sources. First, he said, some of the biggest players in the energy market are increasingly interested in controlling the availability of, and access, to oil. This a change from the past emphasis on selling and distributing oil. For example, he said, "the Saudis and Kuwaitis have put together, by my best estimates, about $13 billion to set up holding companies, the sole purpose of which is to control future consignments of crude oil coming from the Caspian basin." Elsewhere, he said, Petrocaribe S.A., a Caribbean oil alliance that is the brainchild of Venezuelan leader Hugo Chavez, has been set up "to guarantee that prices of crude oil and oil products coming north from the Caribbean will be higher."

Second, he said, the energy industry is shifting more attention

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Economist Calls for "Revolutionary Thinking" to Resolve Financial Crisis

By Randy Myers

Economist and long-time investment strategist James Griffin says the United States needs to embrace revolutionary thinking to resolve its current financial crisis. Now an economic consultant and portfolio advisor to ING Investment Management and editor of the ING *Investment Weekly* newsletter, Griffin told participants at the SVIA Fall Forum in Washington, D.C., that while the Federal Reserve has been working hard to ease the credit crunch in the fixed income markets—the nation's top economic priority—there's no evidence yet that it's easing what he calls our "debt deflationary spiral."

In addition to reconsidering conventional dogma such as the idea that tax cuts are always good or that housing prices always go up, Griffin argued for revisiting the requirement that financial institutions use mark-to-market accounting for the assets and liabilities on their balance sheets. "It's telling us we're dead," he said. "So we have to have some adjustments."

Griffin also said the country will have to learn to spend within its means, both at the household and federal government levels, especially since our reliance on foreign countries to finance our spending spree of the past decade or so jeopardizes our national security by increasing their leverage over us. "From the fall of the USSR to the early part of this decade, the United States soared like an eagle," Griffin said. "We addressed problems we had in the early '90s. We got our current account to almost balance, and we turned a federal deficit into a surplus. The rest of the world was happy to send us their money, and as a result, the dollar was strong and interest rates were low, as was inflation. But, in effect, we were also becoming the fois gras goose; we were being force fed other people's exports and savings." Now, Griffin says, we must find out whether the United States can morph into yet another bird—a phoenix that can rise from the ashes of the current crisis.

One of our challenges, he said, will be figuring out how to stimulate the economy while simultaneously encouraging the savings necessary to reduce our dependence on foreign financing. Tax cuts worked during World War II, he noted, but were made in the interest of saving the world. "The purpose of tax cuts today has been to allow us to get bigger houses and cars," he observed. "That seems a somewhat less worthy cause."

Griffin pointed to Iceland as an example of just how bad things could get. "We're not Iceland, but take heed," he said. "Iceland has bank liabilities so large relative to the size of its GDP that what amounts to a financial insolvency problem is being transmuted into a sovereign or national insolvency problem."

For all his dire predictions, Griffin said he believes the United States will overcome its financial problems. "In this country, we still hold the best hand in terms of our demographics, our institutional structures, our civic cohesion," he said. "If there were other hands I could trade for what we've got, there's no trade I would make. If we can screw our heads on right and screw our courage to the sticking points, so to speak, we're going to come out of this alright. But for the moment, we're in an authentic panic, I think, and one that won't show any signs of easing until we see spreads start to come in and some markets start to move again, especially up."

Potential Crisis in Oil Derivatives Market

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to the development and distribution of natural gas, particularly in liquefied form. In the past, he noted, natural gas could be transported only as far as pipelines could deliver it. Now, with the improved technology to convert natural gas to a liquid, tankers are being built not to carry crude oil but to carry LNG. "Liquified natural gas is going to fundamentally change how we view energy," Moor said. While it currently represents about half a percent of the natural gas used in the United States, he said, that should increase to 8 percent by about 2016, and perhaps 15 percent by 2020.