SVIA STABLE TIMES

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Stable Value Remains a Popular, High-Performing Asset Class

By Randy Myers

Stable value funds were a popular asset class in 2008, as investors eager to avoid the carnage in the stock market flocked to the steady returns and capital preservation features that stable value funds offer. But their appeal is hardly new.

Human resources and consulting firm Hewitt Associates has been tracking the investment behavior of 401(k) plan participants since 1997. It has found that plan participants have long allocated a significant portion of their assets to stable value funds, ranging from a low of 17 percent in 2000 to a high of 37 percent in 2008.

Historically, older investors have been the heaviest buyers as they seek to preserve what they have saved as retirement age approaches. But retirement plan participants of all ages make use of stable value funds, reports Gina Mitchell, president of the Stable Value Investment Association. Opening the 2009 SVIA Fall Forum in Washington, D.C., Mitchell shared data compiled by

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It's Too Soon to Predict the Death of the 401(k) Plan

By Randy Myers

On October 9, 2009, *Time* magazine ominously titled its cover story "Why It's Time to Retire the 401(k)."

It may have been a little premature. While the 401(k) may be wounded, it is hardly ready for the graveyard.

"If your sole source of information about the status of 401(k) plans over the past 12 months was the public press, you probably came to the conclusion that the 401(k) was dead, everyone had stopped contributing to them, participants withdrew or took hardship withdrawals in staggering amounts, and employers stopped making matching or profit-sharing contributions to those plans," Doris Fritz, vice president of investment consulting services for Fidelity Investments, told participants at the 2009 SVIA Fall Forum. "Luckily, the perception does not match reality."

Fidelity provides recordkeeping services for more than 17,500 defined contribution plans, including 401(k) plans. As of June 30, those plans served 11.2

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Retirement Security Outlook May Be Worse than Projected

By Randy Myers

For all the dire warnings about Americans not saving enough for retirement, we may be underestimating the true extent of the problem, warns Dallas Salisbury, president and CEO of the Employee Benefit Research Institute, a non-profit research organization.

Many studies assume that people will only need 70 percent to 80 percent of their pre-retirement income after they stop working, Salisbury told participants at the 2009 SVIA Fall Forum. While those studies may forecast an income shortfall for some groups—single women are particularly vulnerable—they can be surprisingly upbeat in their overall conclusions.

The problem, Salisbury says, is that the studies do not take into account the cost of healthcare in retirement, including the possible need for long-term care. Include those variables, he warns, and almost everyone is at risk of outliving their savings. Rather than needing 70 percent to 80 percent of pre-

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million participants and held nearly $600 billion in assets. And while 6.4 percent of those participants were decreasing their plan contributions in March 2009, right at the very bottom of the bear market in stocks, another 5.8 percent were actually boosting deferrals, said Stephen Setterlund, vice president of marketing and plan sponsor strategy for Fidelity Retirement Services and a featured speaker at the Fall Forum. By June, the picture was even brighter, with 4.7 percent boosting deferrals and only 3.1 percent decreasing them.

"Most plan participants today had never experienced a real market downturn before 2008," Setterlund said. "When they finally did, they didn't run or pull their money out. At least, most didn't."

Nor did investors dramatically change their asset allocation strategy. In June 2007, participants in Fidelity-managed plans had 62 percent of their assets in equities and self-directed brokerage accounts. That figure sank some over the course of the next two years but still remained above the 50 percent mark at 52 percent. And that did not include the 24 percent of assets held in blended and lifecycle funds, which typically have substantial allocations to equities. In fact, direct allocations to short-term, stable value, and fixed income investments rose only 4 percentage points over that two-year period, to 24 percent from 20 percent.

"Equities power the portfolio, and while they can be scary, participants ultimately figure that if they are going to reach their retirement goals, they need something to fuel that engine," Setterlund said. "We are still seeing a low number of exchanges within accounts; people are holding onto their investments."

Still, investors are mindful of what happened to their accounts in the great market downturn that stretched from October 2007 to March 2009, and more of them are looking for help in figuring out how to manage their retirement nest eggs. At Fidelity, one option for getting help is Portfolio Review, an online educational tool investors can use to develop an asset allocation strategy and choose investments appropriate for their goals. Through much of 2008, only about 5,000 participants with access to Portfolio Review were using it in any given month, Setterlund reported. By June 2009, that figure had climbed to about 40,000.

Reactions to the financial market meltdown also were moderate among Fidelity's plan sponsor clients, Setterlund said. Only 8 percent suspended or reduced their employer match from September 30, 2008, through June 30, 2009.

"The employers I work with every day recognize the need for that matching contribution," Setterlund said. "They recognize it as a key benefit, and typically a competitive benefit, in their space. A lot of the employers who are moving to suspend or eliminate their match are struggling with different things. They're struggling with corporate survival. That's the reason they're doing it. When that happens, it's not about the benefit plan anymore; it's about having a viable company that can continue to employ individuals."

In plans where the match was reduced or suspended, Setterlund said, 5 percent of participants reduced their deferrals to the plans. SVIA

SVIA Board Elects New Officers

SVIA's Board of Directors' elected two new officers this Fall. The Board unanimously elected Stephen LeLaurin and James King to serve as Committee Chairmen. INVESCO Institutional's LeLaurin was elected to serve as the Chairman of the Committee on Data and Research. Prudential Insurance's King was elected as the Chairman of the Committee on Communications and Education.

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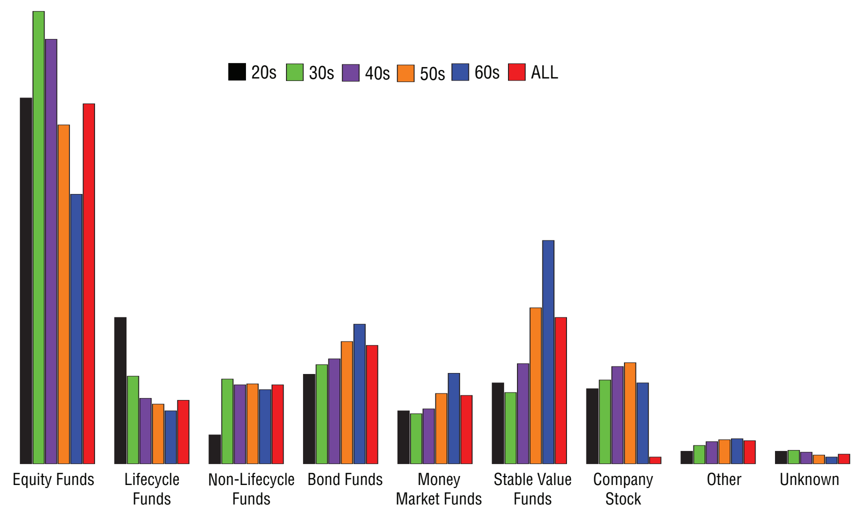
the Investment Company Institute, a trade organization for mutual fund companies, showing that even investors in their 20s and 30s held nearly 8 percent and 9 percent of their assets, respectively, in stable value funds last year.

Stable value investors have been rewarded for their loyalty. According to data compiled by Wharton School professor of finance David Babbel, stable value funds produced mean annual returns of 6.26 percent over the 20 years from January 1989 through December 2008, outperforming money market funds by more than 2 percentage points and intermediate-term bonds by about half a percentage point. Their performance trailed the numbers posted by large company stocks and small company stocks—8.8 percent and 12.2 percent, respectively—but with far less volatility. Meanwhile, while stable value funds had a standard deviation of just 1.6 percent and never returned less than 4.3 percent in a given year, large company stocks had a standard deviation of 19.6 percent, and small company stocks had a standard deviation of 22.9 percent. The worst years for large and small stocks: -37.7 percent and -36.7 percent, respectively.

"Whether you look at the results monthly or annually," said SVIA chairman Marc Magnoli, "you'll see that stable value does what we say it does. It produces returns comparable to intermediate-term bonds but with stability comparable to a money market fund."

Participants of All Ages Use Stable Value Asset Allocation by Age for 2008



Source: 401(k) Asset Allocation, Account Balances, and Loan Activity in 2008, Research Perspective, October 2009, Volume 15, Number 2, Investment Company Index.

Why Stable Value Is a Key Part of Asset Allocation

Summary Statistics (January 1989 to December 2008)

	Large Stocks	Small Stocks	Long-Term Government Bonds	Long-Term Corporate Bonds	Intermediate Gov't/Credit	Stable Value	Money Market
Net Monthly Returns							
No. of Months	240	240	240	240	240	240	240
Mean	0.65%	0.94%	0.73%	0.62%	0.46%	0.51%	0.33%
STDEV	4.18%	5.69%	2.79%	2.44%	0.97%	0.12%	0.17%
Miniumun	-16.88%	-20.71%	-9.90%	-8.89%	-2.80%	0.29%	-0.03%
Maximum	11.28%	23.58%	14.36%	15.53%	3.20%	0.80%	0.76%
Sharpe Ratio	**0.075**	**0.107**	**0.148**	**0.118**	**0.138**	**1.477**	
Net Annual Returns							
No. of Years	20	20	20	20	20	20	20
Mean	8.80%	12.15%	9.16%	7.60%	5.73%	6.26%	4.08%
STDEV	19.63%	22.90%	10.56%	7.94%	4.31%	1.57%	2.07%
Minimum	-37.66%	-36.72%	-10.02%	-8.05%	-3.38%	4.92%	-.071%
Maximum	35.52%	60.70%	29.80%	25.41%	13.66%	9,60%	8.36%
Sharpe Ratio	**0.248**	**0.348**	**0.481**	**0.447**	**0.426**	**1.643**	

Source: David Babbel, PhD. and Miguel Herce, Ph.D., March 2009 Analysis of Stable Value Funds from 1989 through 2008. Large stock returns are total returns on the S&P500 Index, Bloomberg. Small Stock, Long-Term Government Bond, and Corporate Bond returns are from Morningstar, SBBI 2008 Yearbook and 2009 update. Intermediate Government/Credit returns are from the Barclays Capital Intermediate U.S. Government/Credit Index, formerly the Lehman Intermediate U.S. Government/Credit Index. Stable value returns are asset-weighted average returns based on data provided by SVIA. Money Market returns are from the Merrill Lynch 3-Month T-Bill Index, Bloomberg.

Retirement Security Outlook May Be Worse than Projected

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retirement income, he said, retirees could need 128 percent.

The healthcare conundrum promises to grow worse with Medicare in financial trouble and paying an ever-smaller proportion of retiree medical expenses. Immediately after its creation in 1965, Salisbury said, Medicare was paying 82 percent of retirees' medical expenses. Last year, it paid 51 percent, and according to recent actuarial reports, that proportion would have to fall to 24 percent to put the program back on the road to solvency. Alternatively, Salisbury said, Medicare taxes would have to increase dramatically, to just short of 9 percent of payroll, to keep paying benefits at current levels.

Even if healthcare costs were not an issue, many people are doing a poor job of saving for retirement, Salisbury said. Too many workers fail to save sufficiently, and too many cash out their accounts when they change jobs. The average Baby Boomer puts 4.1 percent of his income into his retirement savings account, he noted, but should be saving 18 percent to 27 percent. Young workers often fail to save at all but should be funneling at least 15 percent of their wages, including employer matches, into retirement accounts.

In addition to saving more and making sure their savings remain invested, Salisbury said American workers should consider annuitizing at least a portion of their retirement nest eggs once they stop working to guard against running out of assets before they die.

While 401(k) plans often come under criticism for being a poor substitute for traditional pension plans, Salisbury pointed out that in 1978, only 16 percent of the people retiring from the private sector received a defined benefit annuity—a pension—when they left their jobs. That percentage peaked at 21.2 percent in 2001. "The old adage that everyone got a pension is a myth," he said. "Every generation has had to do it for themselves, mostly."

Employers can help workers improve their odds of achieving a financially secure retirement, Salisbury said, by adopting automatic enrollment and automatic salary deferral increases for their retirement savings plans. Offering lifecycle funds as investment options also can help by making it easier for plan participants to build diversified investment portfolios.

Individuals who will face retirement with the best chance at financial security, Salisbury concluded, will be those who save a lot, take moderate risk with their investment portfolios, and plan ahead for how they will convert those savings to income in retirement. Those who save too little and invest in the highest-risk portfolios, or do not save at all, will be at greatest risk of outliving their assets. SVIA

Prudential Economist: A Great Time for Stocks

By Randy Myers

The devastating decline in stock prices from late 2007 through early 2009 has driven many nervous investors out of the stock market and into the relative safety of bonds. That has been good news for the bond market, and it is a scenario that should continue to play out through the first quarter, if not the first half, of 2010, says Robert Tipp, managing director and chief investment strategist for Prudential Fixed Income Management. But it also obscures the fact, he says, that this is a great time to invest in the stock market.

Stocks staged an impressive rally through the final three quarters of 2009, but Tipp, addressing the 2009 SVIA Fall Forum in October, argued that its bull run was just beginning. He noted, for example, that the earnings yield on the S&P 500 stock index at that time—its trailing earnings divided by its price—was only about 5 percent. That's well below its historical range of 6 percent to 7 percent, a sign that stocks may be undervalued. It's also about 150 basis points above the yield on 10-year Treasury notes, suggesting that stocks are undervalued relative to bonds, too.

"Stocks were unbelievably cheap in March," Tipp said. "They are cheap now—as cheap as they were back in the 1970s."

Certainly, he said, any further advances by either the stock or bond markets will not be constrained by a lack of fuel. He noted that retail and institutional investors have stockpiled trillions of dollars in money market funds while waiting for a clear signal that the investing environment has stabilized. All of that represents money that could be put to work in the equity and fixed income markets.

Retail and institutional investors have stockpiled trillions of dollars in money market funds while waiting for a clear signal that the investing environment has stabilized. All of that represents money that could be put to work in the equity and fixed income market.

The economy shouldn't get in the way. As Tipp accurately forecast, the U.S. gross domestic product resumed growing in the third quarter of 2009, rising at a 3.5 percent annual rate and reversing four consecutive quarterly declines.

Still, Tipp warned that the pace of this economic recovery will trail the 6 percent to 8 percent rate that has been typical after past recessions. Inflation will remain subdued, he said, and the Federal Reserve will keep interest rates low at least through the first half of 2010, and possibly for the entire year, so that the economy can

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A New Nation of Savers? Maybe

By Randy Myers

It is possible that the economic upheavals of the past two years have transformed America into a nation of savers. But don't count on it.

Yes, the national savings rate has jumped to 5 percent after falling to nearly zero around the start of this decade. And yes, there are good reasons for this new trend to continue. Consumers have seen their net worth crippled by the housing slump and the 2008 downturn in the financial markets. They face a $13.8 trillion mountain of personal debt that will take years to work down. Both factors should keep a lid on personal spending.

But as Roger Selbert, editor and publisher of the trends newsletter *Growth Strategies,* told participants at the 2009 SVIA Fall Forum, the so-called "wealth effect" could lead Americans to revert to their former spending patterns as soon as the economy begins to recover. The wealth effect refers to the tendency of people to spend more not just when they truly are wealthier—when they get a raise at work, for example—but also when they simply feel wealthier, perhaps because the value of their home or stock portfolio has increased. For every extra dollar of perceived wealth, economists contend, people increase their spending by 7 percent.

"This suggests that once our perception of wealth returns, we will be all too eager to borrow and spend again," Selbert told his SVIA audience. In fact, that may be happening already. The U.S. Consumer Demand Index, which surveys 1,000 households monthly on their immediate spending plans, is still "very low" by historic standards but trending up, said Selbert, a principal in the firm that publishes the index.

Whether a return to heavy spending makes sense, for individuals or the country, is an open question. Consumer spending is a big driver of the U.S. economy, but Americans still face a difficult economy and job market in the decades ahead, Selbert warned. Thanks to our growing federal debt, he said, both higher taxes and higher interest rates appear to be inevitable, and both would be a drag on the economy. So would slowing productivity gains, which the renowned management consulting firm McKinsey & Co. is predicting, he said.

All these factors will weigh on the labor market, already in dire shape. The current high unemployment rate of over 10 percent would be even worse—about 17 percent, Selbert said—if people involuntarily working part time were included in the figure. Adding in those who have simply given up looking for work, it would soar to the 25 percent range.

It's not that jobs are unavailable, Selbert stressed, but rather that many of the jobs that are available require skills the unemployed do not have. Some of the strongest job demand, he noted, is for accountants, engineers, researchers, healthcare workers, and actuaries—not positions that the typical furloughed manufacturing worker or bank employee can handle. "A lot of good jobs are going begging," Selbert says, "and that paradox is going to continue."

Meanwhile, even those who have jobs face a future in which it could be difficult to see much wage improvement. The average number of hours worked by hourly employees has been trending lower for two decades, Selbert said, and now stands at just 33.2 hours per week.

A lot of good jobs are going begging, and that paradox is going to continue.

This isn't the sort of data that argues for increased consumer spending. Nor does the fact that millions of Baby Boomers are heading into retirement with savings accounts decimated by the financial market turmoil of the past two years. Those Boomers can expect to work longer than they had planned, Selbert said, and to struggle with how best to draw down their retirement savings—just as they struggled to accumulate it. He predicted that retirement savings plans will eventually incorporate some form of annuity that will generate a guaranteed stream of income for retirees.

In the meantime, he said, working longer won't necessarily be bad for many people. Thanks to a longer life expectancy than previous generations, he said, Americans today can afford to work an extra five years and still enjoy more years in retirement than our ancestors. And from a financial perspective, he said, "working an extra five years can make all the difference. You save more, you reduce the number of years those savings need to support you, and you qualify for a larger Social Security benefit."

Selbert was not wholly negative about the outlook for the U.S. economy. It is, he noted, still the largest in the world by a wide margin, the only advanced economy with a growing population and an innovative economy. He predicted that the U.S. dollar will remain the global reserve currency because there is simply no realistic alternative and said that the United States will remain among the most technologically competitive nations in the world. His biggest concern, he said, is that the country will become less dynamic, fearful of taking risks and investing in new business opportunities.

But who knows? If the wealth effect proves sufficient to get consumers spending again, maybe it will spur investors to take on new risks again.

Conservative Policy Analyst Warns of Boosting Entitlement Programs

By Randy Myers

The United States is facing an "entitlement crisis" that threatens its long-term economic health, according to a member of the conservative Institute for Policy Innovation (IPI), a Dallas-based think tank. Washington is threatening to compound that crisis, he argued, if it embraces currently proposed healthcare reforms.

Peter Ferrara, director of entitlement and budget policy for IPI, told participants at the 2009 SVIA Fall Forum that federal spending since World War II has been fairly stable at about 20 percent of gross domestic product but is now poised to climb significantly higher as costs for three entitlement programs—Social Security, Medicare, and Medicaid—continue to rise. While President Obama and Congressional Democrats are pushing healthcare reforms they say would be cost-neutral, a skeptical Ferrara warned that the projected cost savings will come from cuts in healthcare services and payments to service providers, which will jeopardize the level of care Americans receive.

Ferrara also predicted that if healthcare reform includes a so-called "government option" healthcare plan, it ultimately will force everyone into that plan and drive up health insurance costs, in part because it will be stocked with "every politically correct vendor and benefit."

In addition, he warned that costs will be pushed higher because, "with the government paying for everything, there will be no incentive for consumers other than to demand as much healthcare as they want."

> *Federal spending since World War II has been fairly stable at about 20 percent of gross domestic product but is now poised to climb significantly higher as costs for three entitlement programs—Social Security, Medicare, and Medicaid—continue to rise.*

Clamping down on costs also will drive doctors and other service providers out of the field, Ferrara predicted, so that demand will outstrip supply and further push prices higher.

A better option for making healthcare available to a wider segment of the U.S. population, Ferrara said, would be to offer financial assistance to those who cannot afford to purchase healthcare insurance on their own. State pools could cover uninsurable risks—people who are too sick to be accepted by private healthcare plans.

A longtime backer of personal accounts within the Social Security system, Ferrara argued

EDITOR'S CORNER

Stable Value: The Challenges and Opportunities Ahead of Us

By James King, Prudential Insurance

This issue of *Stable Times* focuses on the diverse topics discussed at the SVIA Fall Forum, which ranged from healthcare reform to changes occurring in the retirement and stable value market. As illustrated by these articles, we are in a period of significant turbulence and change. However, this change also presents us with an opportunity to strengthen our products while finding innovative solutions to current challenges.

Potential solutions discussed in this issue include bringing transparency to the retirement market place, building stable value capacity, and creating the right solutions for healthcare reform. These solutions may help ease the fear Americans have for their financial future.

While the outlook for the U.S. economy is still uncertain, we must ensure that the stable value asset class continues to perform well and provide a safe haven in workers' retirement plans. Going forward, we must continue to advocate for positive change in order to strengthen Americans' ability to achieve a secure retirement.

I encourage you to find the energy to effect this change in your field of expertise during these difficult times so that Americans can once again feel secure about their financial future in retirement.

SVIA Sets Meeting Schedule for 2010 to 2012

SVIA set the Annual National Membership and Fall Forum meeting schedule for the next three years. The Fall Forum will be held for the next three years at the Fairmont Hotel, which received high marks from past Fall Forum attendees. The meeting dates are: November 16-18, 2010 (Tuesday-Thursday); November 15-17, 2011 (Tuesday-Thursday); and November 12-14, 2012 (Monday-Wednesday).

SVIA's Fifth Spring Seminar will be held April 11-13, 2010 at the Four Seasons in Palm Beach, Florida. To learn more about the Spring Seminar, please visit SVIA's website: www.stablevalue.org.

Borzi Warns of a "Crisis of Confidence" in U.S. Retirement System

By Randy Myers

Many Americans worry that they will never enjoy a financially secure retirement. Phyllis Borzi is intent on making sure they do.

Assistant secretary for the Department of Labor's (DOL) Employee Benefits Security Administration, Borzi sees reform of the nation's private retirement as critical to the long-term welfare of American workers.

"We face a crisis in terms of confidence in all of our social institutions, but particularly our retirement system," Borzi told participants at the 2009 SVIA Fall Forum in Washington, D.C. "In the 35 years since the passage of the Employee Retirement Income Security Act, the market has shifted. Most people are no longer in defined benefit plans; they are in 401(k) plans in which the investment responsibility is theirs. They are expected to make decisions that will have a long-range impact on their retirement security, yet many have a hard time figuring out what is going on with their investments."

To help them, Borzi said, the DOL is seeking to bring more transparency to the retirement marketplace, with more and better information about the investment options offered in retirement plans and what they cost.

In June, for example, the DOL held a joint hearing with the Securities & Exchange Commission (SEC) on target-date funds, which are popular investment options in many retirement funds. Many investors were stunned when those funds, marketed as highly diversified and endorsed by the DOL as "qualified default investment alternatives," sustained significant losses from late 2007 through early 2009. The DOL and SEC want to figure out how the retirement industry can best describe the funds to plan participants without being misleading, overly optimistic, or overly frightening in assessing their risks.

"It's an issue," Borzi said. "People don't understand how the glide path for these funds work or that, if the market collapses, their funds can turn out to be just the same as other mutual funds. There is a lot of work to be done. People assume they have put their money into something that is risk free, and as we have learned, there is virtually nothing that is risk free."

The push for increased transparency in the retirement plan market began under the Bush administration. "We (the Obama administration) come at it from a somewhat different point of view than the previous administration," she said, "but the goals are the same. We want to empower plan participants and plan fiduciaries with the tools they need to make good, solid, reasonable decisions."

High on the DOL agenda, Borzi said, is the redrafting of a regulation promulgated by the department under the Bush administration that would have allowed investment managers to offer investment advice to retirement plan participants, subject to certain conflict-of-interest provisions. The Obama administration delayed implementation of the regulation shortly after taking office, arguing that its conflict-of-interest provisions weren't sufficiently robust. Now, Borzi said, "we're about to propose that the regulation be withdrawn in its entirety, and we plan to issue a new and much more narrow regulation that is more faithful to the provisions of the statute that called for its creation."

Borzi said the DOL also is nearing completion of proposed regulations under ERISA Section 408(2)(b) that would require retirement plan service providers to make additional disclosures to their clients about their compensation and any potential conflicts of interest. The new regulations also would spell out how plan fiduciaries must share information about plan costs with plan participants.

The DOL also is looking into solutions that can help retirement plan participants convert their nest eggs into reliable streams of income once they retire. It recently issued a request for information, along with the Treasury Department, to find out what types of products are available for the retirement plan market, what the barriers are to plan sponsors making them available, and what plan sponsors and vendors can do to educate plan participants about their use. For many retirees, Borzi said, taking their retirement savings in the form of a stream of income may be preferable to taking it in a lump sum. SVIA

SVIA Elects New Board Members

SVIA members elected four individuals to SVIA's Board of Directors. Marijn Smit, who serves as a senior vice president for AEGON Stable Value Solutions was elected to his first term on the Board. Marijn was appointed to the Board two years ago to fill a seat that became open. Edward Adams, who is a manager for Defined Contribution Strategies and Investment for the IBM Retirement Funds, was elected to a second term. JP Morgan Asset Management's Peter Chappelear and Prudential Insurance's James King were elected to the Board. Chappelear is a vice president and stable value fund manager. Jim King is the vice president and head of Prudential Retirement's Stable Value Markets Group. SVIA

Stable Value: Revisiting the QDIA Question

By Randy Myers

Many investment professionals—especially those in the stable value industry—continue to believe that stable value funds should be considered a "qualified default investment alternative" (QDIA) by the U.S. Department of Labor (DOL). The performance of stable value funds during the steep market downturn of 2008, when the average stable value fund earned 4 percent, has only amplified their chorus.

QDIAs are investments that, when chosen by retirement plan sponsors as their plan's default investment option, relieve the sponsor of responsibility for the investment's performance, provided it was prudently selected and monitored. The current list of QDIAs, as created by the DOL, includes target-date or lifecycle funds, managed accounts, balanced funds, and, for the first 120 days of plan participation only, a capital preservation product such as a stable value or money market fund.

One way the stable value industry can win a broader role for its products and perhaps advance their potential as a QDIA, says James King, vice president and head of stable value markets for Prudential Retirement, is to continue educating retirement plan participants about stable value's role as a safe investment option and portfolio diversification tool. While a stable value fund may not be the right default option for every young worker, he says, some plans have demographics in which a significant majority of the assets are concentrated in the accounts of near-retirees. For them, a stable value fund may be the ideal default investment choice.

"Shouldn't the sponsor of that plan have the option of choosing stable value as their QDIA," he asked in an address to the 2009 SVIA Fall Forum, "or somehow have the protection of a safe harbor outside of a QDIA, so that the selection of stable value as an investment choice would hold them harmless?"

> ***Some plans have demographics in which a significant majority of the assets are concentrated in the accounts of near-retirees. For them, a stable value fund may be the ideal default investment choice.***

Certainly, the appeal of stable value funds has not been lost on investors themselves. Approximately 50 percent of defined contribution plan platforms offer stable value products, King said, and in 2008, plan participants transferred more than $5 billion into stable value funds from other investment options.

Prudential has been doing its part, King said, to jump-start the education process. It has created Webcasts and "plain English" disclosure documents for plan sponsors explaining how their general account stable value product works. It also has begun sharing with plan sponsors the market-to-book-value ratios for its stable value funds.

During the summer of 2009, King noted, Prudential, along with MetLife and the Stable Value Investment Association, testified before the ERISA Advisory Council on the subject of adding stable value funds to the list of qualified default investment alternatives. The council indicated that it was likely to advise the Secretary of Labor that it is not appropriate at this time to revisit the subject. Indeed, in a separate address to the SVIA Fall Forum, Phyllis Borzi, assistant secretary for the DOL's Employee Benefits Security Administration, said the DOL has no plans to reopen the QDIA lineup issue.

For now, King remarked, regulators are more interested in seeing increased disclosure about stable value funds and their risks, both for plan sponsors and plan participants.

Still, he said, the council's response wasn't the worst possible.

"The door isn't closed," he said hopefully. "This is Washington, and anything can happen."

Speaking later at the SVIA Fall Forum, Jeffrey Martin, manager of the national tax office for accounting firm Grant Thornton LLP, predicted that Congress will eventually revisit the DOL's decision not to count stable value funds as a QDIA, "especially when you look at how well stable value funds have done over the last 12 to 18 months versus the S&P 500 stock index, bonds, and money market funds."

When it decided what should qualify as a QDIA, Martin said, the Department of Labor was focused more on making sure participants were getting an ample return on their investments and less on making sure they were protected against losses. Now, he said, "after seeing plan participants experiencing 20 percent to 30 percent reductions in their 401(k) accounts during the recent market downturn, versus staying the same or gaining in a stable value fund, I think the issue of protecting against losses will be taken into account."

A Multi-Part Plan for Rescuing the Private Retirement System

By Randy Myers

Beginning in 2011, an average of 4 million U.S. Baby Boomers will reach the age of 65 every year for the next 18 years. Many will not be able to afford a traditional retirement, says Susan Potter, managing director and manager of marketing and branding for BNY Mellon Asset Management, warning that one in five, unless they change their savings habits, can expect to outlive their retirement assets.

The future doesn't have to be so bleak, she argues. Addressing the 2009 SVIA Fall Forum, Potter identified five areas where the government, employers, and retirement plan vendors could work together to improve the outlook for the next big wave of retirees. Her ideas draw, she said, on work done by her own firm and the Financial Services Roundtable, an organization of 100 of the largest financial services firms catering to the U.S. retirement plan market.

To maximize access to retirement plans and to increase the amounts individuals save for retirement, Potter said the federal government should give employers greater flexibility to increase the default rate at which workers contribute to their retirement plans. The government also should facilitate a voluntary, automatic IRA program, administered by the private sector, to supplement existing retirement plans or to help people who don't have access to an employer-sponsored plan. And, she said, the government should create a mechanism to reduce "leakage" that occurs when people transitioning from one job to another cash out of their retirement plans rather than roll their account balances into a new plan. Over the next year alone, she said, as much as $200 billion will be lost from retirement plans in this way.

To help low-income households close their savings gap, Potter said, Congress should expand and improve the Saver's Credit by, among other things, making it fully refundable. It also should stop distributing the credit as an actual tax credit in favor of a direct deposit into a retirement account. She called for increasing the income limits for Saver's Credit eligibility to $65,000 for couples and increasing the credit or "match" to 50 percent for all eligible families.

To mitigate the impact of recent negative market conditions, Potter suggested doubling the cap on retirement account contributions for the next five years. She also endorsed creating incentives that would encourage employers to keep their defined benefit plans in place and drive the adoption of hybrid retirement plans that feature characteristics of both defined benefit and defined contribution plans. She called, for example, for allowing employers to shed only a portion of a pension plan rather than terminate it completely and

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Task Force Seeks to Build Stable Value Industry's Capacity

By Randy Myers

The stable value industry did not escape unscathed from the financial market crisis of 2008. While stable value funds did what they were designed to do throughout the market meltdown—protect investors' principal and generate positive returns—the industry itself was hit with capacity constraints as banks and insurance companies reassessed risks. That has left some stable value managers scrambling to secure the wrap contracts they need to ensure their interest rate and book-value withdrawal guarantees. Where capacity has not been available, they have been forced to hold higher levels of cash than normal, pressuring fund yields.

In response to these events, the SVIA has created two task forces aimed at boosting wrap capacity. One is working with existing wrap issuers to overcome capacity hurdles, and the other is seeking to attract new players into the business.

Addressing the capacity problem requires an understanding of the factors contributing to it, and interviews with existing wrap providers have uncovered several issues, said Adam Silver, director of insurance and pension solutions with Royal Bank of Canada, at the 2009 SVIA Fall Forum. All revolve around the idea that stable value funds may expose wrap issuers to more risk than previously imagined, particularly long-tail credit risk. Issuers also worry that because of the evergreen nature of many wrap contracts, there is no efficient way to get out of them, should they ever wish to do so, without disrupting the stable value marketplace.

Silver said many wrap issuers believe that investment guidelines for stable value funds need to be narrowed and made more conservative. "We recognize the need to provide a return, on a consistent basis, that outperforms money market funds," he said. "But we entered a period of time where yield became everything, and I think it got us into situations where the volatility of those underlying assets was too high, particularly with respect to spread duration."

Many wrap issuers now argue that they should be allowed to re-underwrite contracts should market conditions warrant it. One possible solution, Silver said, would be to create amortizing structures that allow for declining duration in a stable value portfolio, ultimately followed by re-underwriting as necessary.

Silver said wrap issuers also are concerned about the inconsistency of wrap contract terms from different wrap providers covering the same stable value fund. That inconsistency, he said, could leave some issuers facing changes to their risk profile based on decisions made by other issuers.

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A Multi-Part Plan for Rescuing the Private Retirement System

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for moving distressed sponsors of defined benefit plans to an ABO (accumulated benefit obligation) funding standard, especially if it helps them avoid bankruptcy.

To help American workers minimize post-retirement risk, Potter encouraged the introduction of insurance, annuities, and other savings products into the retirement plan market through regulatory flexibility and tax incentives. She also called for increasing employer tax incentives for offering benefit programs and proposed that employers who freeze or terminate defined benefit plans be required to offer defined contribution plans or Individual Retirement Accounts (IRAs) with automatic enrollment and matching employer contributions in their place.

Finally, Potter recommended that the government create incentives for people to stay in the workforce longer, thereby allowing them to save more for retirement and shortening the time they must depend on savings for income. For example, she said, the government might introduce tax incentives for sponsoring employer placement programs for older workers and allow retirees to continue to fund their 401(k) accounts through pre-tax deferrals until age 70.

"These recommendations are not things that anyone with a clean sheet of paper would say are ideal for solving our crisis," Potter concluded, "but we do think they will make a material difference. Importantly, we also think they have some chance of making it through Congress."

Task Force Seeks to Build Stable Value Industry's Capacity

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"There needs to be standardized language in the documentation for wrap providers and more communication between wrap providers and managers on particular deals," he said. He suggested the industry might model the way swap agreements are handled today, with a standard document that is simply modified as needed.

Finally, Silver said, wrap issuers have come to consider collective stable value funds, which manage assets for multiple retirement plans, less diversified, and therefore riskier, than previously imagined. "When some collective funds experience problems and their crediting rates get low, the ability for individual plans en masse to enter a quick exit queue presents a potentially very big tail risk," he said. "I don't think we have a solution to that concern yet, but I think capacity for collective funds will be constrained until we come up with a way to avoid this systemic risk."

As for enticing new entrants into the wrap business, attorney Al Turco, managing partner of the law firm Pepe and Hazard LLC, warned that it is likely to be a "long, arduous process," not only because of the concerns outlined by existing wrap issuers but also because financial services firms in general are being extraordinarily careful about entering new markets right now.

Despite the challenges, Silver and Marijn Smit, senior vice president with AEGON Stable Value Solutions Inc., both suggested that the outlook for improving capacity isn't overwhelmingly bleak. "If we can do something with the design of the product to reduce the tail risk, that should get things moving," Smit said.

"We're not giving up," Silver added. "We want to find a way to have a healthy and attractive product going forward. We have always believed that stable value is one of those few investments for participants that really work. If you had your money in a stable value investment in September 2008, you were a very happy person in March 2009. People who had a dollar in stable value in September 2008 had more than a dollar in March 2009. People believe in our product."

Outlook: Rethinking Stable Value

By Randy Myers

Chastened by the financial market turmoil of 2008, wrap issuers are pushing stable value managers to adopt more conservative investment guidelines and more restrictive book-value guarantees for plan participants. While that may make wrap issuers more comfortable—and may be appropriate to some degree—stable value managers warn that, in the extreme, it could frustrate plan sponsors who are delving more deeply than ever into the inner workings of their stable value funds.

"In a matter of 12 months, plan sponsors have not only become educated about stable value but have also become borderline experts with a new understanding and appreciation for stable value," Tony Luna, vice president and stable value portfolio manager for T. Rowe Price Associates, told participants at the 2009 SVIA Fall Forum. "They're asking tough questions."

Stephen LeLaurin, senior client portfolio manager for Invesco Institutional, joined Luna in a roundtable discussion on the future of the stable value industry, arguing that some wrap issuers may be overstating the risks embedded in stable value funds. He noted, for example, that some have begun to measure risk by the notional value, or total size, of a stable value fund, as opposed to the more traditional metric, the ratio of the fund's book value to its market value.

LeLaurin also questioned the push by some wrap providers to classify an ever-broader array of investments as "competing funds"

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Outlook: Rethinking Stable Value

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within a retirement plan. Traditionally, a competing fund has been another fixed income fund, usually a money market fund, that could draw money away from the stable value fund if plan participants tried to arbitrage their differing yields. Wrap issuers can generally veto the presence of a competing fund in a plan. But now, LeLaurin said, some are trying to classify "anything that competes for the participant's wallet" as a competing fund, including equity and TIPS funds, which could unduly limit participants' investment flexibility.

In the interest of preserving some of that flexibility, LeLaurin suggested that the stable value industry reconsider how it defines employer-initiated events. Those are events, such as mergers or layoffs, that could trigger participant withdrawals or transfers from their stable value fund. Many wrap contracts limit a fund's book-value guarantees in the event of such events. "We need to be careful about how we treat participants," he said. "There is a risk of overplaying what happens when participants withdraw money from stable value funds."

Peter Chappelear, vice president and stable value fund manager for JPMorgan Asset Management, echoed LeLaurin's sentiments. Illustrating the potential impact more restrictive fund designs could have on customers, he cited the example of a plan sponsor that wanted to add an ultra-safe U.S. Treasury money market fund to its investment lineup in 2008 in the midst of the financial crisis but was prohibited from doing so by its stable value fund wrap issuers. Later, in its role as a plan fiduciary, the sponsor wanted to issue monthly statements to its plan participants disclosing the book-to-market value of its stable value fund and explaining its implications. Again, wrap issuers protested, warning that such disclosures might induce participant withdrawals. "Yet again, the sponsor got pretty frustrated," Chappelear said. "They were particularly frustrated because, in their perception, they weren't allowed to act like a prudent fiduciary."

Chappelear said he worries that plans sponsors may come to feel that they don't have control over their stable value funds and ultimately abandon them. He encouraged the industry to come up with innovative ways to meet the needs of its customers. For example, he said, it might start thinking about stable value funds as being less like conservative bond funds and more like enhanced money market funds. "If you take a money market fund and mix it with a stable value fund in some ratio, maybe the wrap providers' handcuffs become a little looser," he said.

Similarly, Chappelear said, stable value managers might consider unwrapping some assets in their funds, such as short-duration bonds. While that would introduce some volatility to the funds, he said it might prove acceptable to plan sponsors and plan participants, especially if funds still guarantee principal on, say, a monthly basis. And, he noted, if funds began wrapping only a portion of their assets—perhaps 50 percent—it would help to alleviate the current constraints on wrap capacity.

Such concepts could prove controversial. For example, Sharon Hoppel, vice president of client portfolio management for Dwight Asset Management, said she still favors the idea of marketing stable value as a product that maintains its principal guarantees at all time. However, she noted that stable value products have been evolving since their inception, while always remaining competitive.

"Products are going to change, strategies are going to change, but there are a lot of smart people in this industry who all have a common goal," Hoppel said. "If we work hard together, we will have a viable product that does offer a meaningful spread over money market funds." SVIA

Cutting the 401(k) Match: Short-Term Savings, Long-Term Risk

By Randy Myers

When employers look for ways to cut the cost of employee benefits, they typically zero in on four things: perks, administrative expenses, health plans, and matching contributions to 401(k) plans. Cutting 401(k) matches became popular in 2009, but the short-term savings they produce will not come without long-term risks, warns Jeffrey Martin, manager of the national tax office for accounting firm Grant Thornton LLP.

In a recent survey of U.S. companies by Grant Thornton, 87 percent of the 283 respondents said they provided a matching contribution for their 401(k) plans prior to 2009. But 20 percent said they had or would eliminate their match in 2009, and another 6 percent said they were going to reduce it. Most took action in the first half of the year, but some were still cutting their match as recently as September.

The cost savings from such cuts, Martin noted, can be impressive. He cited the example of a large company with about 200,000 employees that eliminated its match of up to 3 percent of salary. Assuming a 60 percent participation rate in the plan, and conservatively estimating average compensation at $40,000 a year, he said eliminating the match will save that company about $144 million a year.

Such savings come with indirect costs, though. One of the main reasons workers participate in their 401(k) plans, Martin observed, is to take advantage of the match, which many regard as

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The Role of Separate Account GICs in Stable Value

By Randy Myers

GICs, or guaranteed investment contracts, were once the cornerstone of the stable value marketplace. Over the past two decades, that role has been usurped by synthetic GICs—portfolios of short- and intermediate-term fixed income securities wrapped by a contract from a bank or insurance company that protects against interest rate volatility. Among stable value managers who are not banks or insurance companies, synthetic GICs now account for more than three-quarters of their stable value assets under management.

Despite the popularity of synthetic GICs, access to them has been constrained in the wake of the financial market upheaval of 2008. As wrap issuers have sought to reduce risk, many have cut back on, or simply eliminated, the underwriting of new business in this area.

In a panel presentation at the 2009 SVIA Fall Forum, four industry professionals explained how separate account GICs—those in which the assets are held apart from the issuing insurance company's general account—have been impacted by the 2008 financial crisis and how they may be used in the future.

The discussion kicked off with moderator Gerry Katz of Diversified Investment Advisors asking two independent asset managers—Susan Graef of Vanguard Group and Mike Norman of Galliard Capital Management—how they use separate account GIC structures in their pooled funds and how they explain the generally low allocation to such products.

Vanguard, Graef said, does not use separate account GICs in its pooled fund, in large part because the issuer owns the underlying assets. "That limits our ability in terms of asset allocation and creates a risk exposure to the issuer," she said. "While the assets are segregated from the issuer's general account assets and we have a little ability to mandate credit quality, it really doesn't give us the diversification we need." She also noted that while separate account GICS are usually participating contracts, Vanguard prefers non-participating contracts when the issuer handles asset management.

Galliard does have a "small allocation" to separate account GICS in its pooled fund, Norman said, and also in some of its separate account, separately managed portfolios. "Not having the ability to manage the underlying assets is a potential hindrance, though," he said. "I think we will have a continued allocation to it, but primarily as a diversification tool."

Katz then asked two stable value wrap issuers—Steve Schaefer of MassMutual's Babson Capital Management subsidiary and Warren Howe of MetLife—how they use separate account GICs. Babson, which was in the market in the 1990s but no longer participates, is now rethinking that position in the wake of the capacity issues in the synthetic GIC market, Schaefer said. MetLife, Howe noted, remains very active in the market.

"We have been in this market for 20 years and have $14 billion of separate account GICs on the books," Howe said. "It is a core competency at MetLife, and we distribute it in a variety of fashions to the stable value manager community." In addition to having large, direct plan sponsor relationships, Howe said, MetLife also has a suite of commingled funds it distributes through the third-party-administrator market.

"The opportunity set has become enormous because of the wrap capacity issues," Howe added. "Much like you would see in the wrap market, however, guidelines have gotten a little tighter, durations have gotten shorter. These are slight modifications, though. We are still strongly committed to the business."

Asked what changes he would like to see in the separate account market to make it more appealing, Howe said he wasn't necessarily looking for any changes to the product, although he would like to see its image improved.

"MetLife accounts for the lion's share of the separate account market," he explained. "What we would like to see is greater recognition among plan sponsors and stable value mangers of the fact that assets in a separate account GIC are segregated from the assets of the insurer's general account and in the event of insolvency are not subject to the normal disposition of the insurance company's assets. We also would like to see people get more comfortable with holding a beneficial interest in a separate account as opposed to having explicit ownership of assets. In a separate account, the insurance company does own the assets, but those assets are held explicitly for the beneficial interest of the participants in that account."

> *"The opportunity set has become enormous…Much like you would see in the wrap market, guidelines have gotten a little tighter, durations have gotten shorter. These are slight modifications, though. We are still strongly committed to the business," says Howe.*

Vanguard understands that the assets in separate account GICS are insulated from the issuer's general account, Graef countered. "But," she said, "I think there are some structural changes needed in the contracts to make that meaningful for us, so that we could actually get those assets in the event we needed to. Products

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The Role of Separate Account GICs in Stable Value

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we have used in the past have kind of addressed that. The other thing, again, is that where asset management is done in-house, the full participation nature of the contract is a dilemma for us. We don't have control of the management or the risk, yet that is something we feel responsible for in the product."

Norman echoed Graef's sentiments. "The common theme is flexibility," he said. "Flexibility partially means the ability to look at options other than having the in-house insurance investment unit manage the assets. Assuming that is an option, then there's always the debate around guidelines. The bus doesn't have to be driven by the actuaries all the time; there has to be some sense of being able to meet in the middle as far as protecting against that black swan risk versus managing in the current market environment. And everyone needs to be cognizant of the need for a competitive fee structure for the product."

Howe noted that, while many insurance companies do handle asset management for their separate account product, MetLife isn't entirely rigid on the subject. "We do in-house management, typically for passive strategies," he said. "But for anything that is actively managed, we work with external sub-advisors. So we do have the ability and flexibility to use outside managers, which I think in this environment has been well-received and maybe tips the scale a little bit for separate accounts."

Katz asked Graef and Howe if access to external management would be the critical factor in swaying them to more use of separate account GICs, or if ownership of the underlying assets would still be a significant issue.

"For us, it's a combination of both," Norman replied. "But our lower allocation to this product does come back to the ownership of assets."

In response to a question from a plan sponsor, Norman also commented on the recent tightening of risk controls and the introduction of higher fees for its stable value fund, and he asked what changes like those could mean for stable value funds relative to money market funds.

"We are seeing a swing in the risk pendulum back to tighter investment guidelines and increased fees as risk committees reassess pieces of the business," Norman conceded. "But we also are seeing that stable value funds are continuing to outperform money market funds. The changes we're seeing—restricted guidelines, increases in fees—are going to have an impact on stable value performance, but at least to this point, it hasn't been too severe. That said, I think if we swing too far—as fees go up and you get too restrictive—there might be more issues. As things stand now, I think there is still a lot of opportunity out there for stable value managers to outperform."

Cutting the 401(k) Match: Short-Term Savings, Long-Term Risk

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"free" money. Taking it away can demoralize employees and make it harder to attract new ones. Indeed, of the 31 percent of employers who automatically enroll participants in their plans but were thinking about modifying or eliminating the match in 2009, nearly half in the Grant Thornton survey estimated that it would have a negative impact on plan participation in the future.

At least some employers are bucking the cutback trend. Martin said 3 percent of the companies his firm surveyed were planning to increase the size of their matching contributions. While some may have been doing so to offset other benefit cuts, he theorized, others might have been looking to do a better job of attracting and retaining employees or to signal the financial stability of their companies.

The companies most active in modifying their retirement plans were those in the technology and retail sectors, Martin said, with 47 percent and 50 percent, respectively, making changes. Companies in the healthcare and tax-exempt sectors were least active, at 0 percent and 7 percent, respectively.

Why Traditional GICs Merit a Fresh Look

By Randy Myers

For two decades, stable value managers have been migrating away from traditional guaranteed investment contracts, or GICs, in favor of their synthetic counterparts. Traditional GICs never disappeared completely, however, and some industry experts suggest it may be time for stable value managers to give them a fresh look.

"Why use GICs in stable value portfolios? It's the flip side of why 20 years ago you began using synthetics," said Peter Bowles, president of stable value manager Fiduciary Capital Management Inc., addressing participants at the 2009 SVIA Fall Forum. "You now have so many synthetics in your portfolio that you need the diversity of GICs."

Kicking off a roundtable discussion, Bowles encouraged his audience to think of GICs as individually negotiated, private placement bonds issued by insurance companies, with features unavailable anywhere else.

Unlike a synthetic GIC, Bowles said, in which the interest or crediting rate fluctuates with the performance of an underlying portfolio of fixed income securities, a traditional GIC, backed by the issuing insurer's general account, guarantees a specified rate of interest for a period of years. And, unlike publicly traded bonds, he noted, GIC contracts can be renegotiated if needed to reduce interest rate risk or credit exposure, or to increase performance or liquidity.

The diversification these products have offered us, particularly over the last 12 to 18 months, has been a great help during these turbulent times.

Some veteran asset managers began steering away from the GIC market in the early 1990s after two prominent issuers, Executive Life and Mutual Benefit Life, defaulted on their contracts. However, Bowles pointed out that over the history of the asset class, only four GIC issuers have ever defaulted, and investors in three of those cases wound up receiving at least 100 cents on the dollar. Even those hit the worst—investors in Executive Life GICs—received 92 cents on the dollar, and state guaranty funds ponied up the 8 cent-shortfall to 401(k) investors. By comparison, he said, the average recovery rate on defaulted bonds is only 43 cents on the dollar. Meanwhile, he emphasized, GICs historically have generated an average yield premium of 43 basis points over comparable bonds.

Due diligence tips

Karen Chong-Wulff, vice president of fixed income for ICMA Retirement Corp., said buyers of traditional GICs must do careful due diligence to reap the benefits of the product. That starts with evaluating the issuer's creditworthiness, an assessment she says should be performed in-house by the buyer's own credit analysts. "Having folks internally who can do the credit research on insurance companies is key to having a GIC program," she said. "You need the ability to go out and interview management. Without that, I wouldn't feel as comfortable about buying GICs.

As with any investment strategy, she added, it is important to build a GIC portfolio with contracts from multiple issuers, rather than just one or two, to mitigate credit and liquidity risk.

Finally, she said, it is important to be in the market consistently. "There are weeks when you can get special terms," she said. "You can negotiate, see patterns, compare what you're seeing with bonds, and know which is more attractive."

Marian Marinack, vice president and senior portfolio manager for Federated Investment Management, said one way buyers can mitigate liquidity risk is by building laddered GIC portfolios, as her firm does, so that some contracts are maturing every month.

"The diversification these products have offered us, particularly over the last 12 to 18 months, has been a great help during these turbulent times," Marinack said. SVIA

Conservative Policy Analyst Warns of Boosting Entitlement Programs

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for adopting that approach for all entitlement programs currently financed by the payroll tax. That would dramatically cut government spending and deficits, he said, while the private money saved and invested for those purposes would invigorate the economy. SVIA

Prudential Economist: A Great Time for Stocks

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head into 2011 "with a full head of steam." Noting that Federal Reserve chairman Ben Bernanke is a student of the Great Depression, Tipp said Bernanke is unlikely to repeat the mistake made by the Federal Reserve following that crisis, when it began to hike rates too early. He said high levels of unemployment, which have persisted despite the economy's turnaround, also will pressure the Fed to keep rates low.

From a global perspective, Tipp argued that most countries have recognized, in ways they did not decades ago, that cooperating with each other politically is in their collective economic interest. That, too, he said, is contributing to improved global economic growth. SVIA