SVIA STABLE TIMES

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IN THIS ISSUE

Weathering the Storm: Stable Value Shines

By Randy Myers

It's easy to see why much of America has acquired a skeptical view of the financial services industry. Over the past dozen years, Wall Street has been rocked by accounting improprieties, the bursting of the tech-stock and real estate bubbles, the Bernie Madoff scandal, and a credit crisis that prompted landmark bankruptcies in the banking and insurance sectors.

"This series of events created a wave of discontent that caused Washington policymakers and the public to take a jaundiced view of all things financial," SVIA president Gina Mitchell told participants at the SVIA's annual Spring Seminar in Scottsdale, Arizona.

The result is that much like Caesar's wife, financial services firms and their products are expected to not only operate in accordance with the law but also be above suspicion.

Fortunately, Mitchell said, the stable value industry has performed with distinction, generating stable and positive returns throughout the most recent financial crisis and its aftermath. During that period, it consistently outperformed money market funds.

continued on page 3

SVIA Board Elects James King Incoming Board Chairman

SVIA's board of directors elected James King as the incoming chairman at its April meeting. King, who will become chairman of the board in January 2012, currently leads the Communications and Education Committee as its chairman. King is a certified financial analyst (CFA) and serves as senior vice president and head of Prudential's Retirement Stable Value Markets Group. At Prudential, King manages both the full service and third party stable value businesses, which represent over $60 billion of stable value assets. He also serves as a member of Prudential's Investment Strategy Committee, which is responsible for providing investment policy guidance and oversight in the management of Prudential's stable value funds.

Jim has applied his stable value experience over the past two years to most of the Association's initiatives. He has contributed to Association initiatives as chairman of the Communications and Education Committee, as an editor of *Stable Times*, as a member of important SVIA Task Forces (such as the one on Dodd-Frank legislation) and the CFTC-SEC Stable Value Working Group, and as a member of SVIA's Event Planning Committee for the Spring Seminar and Fall Forum.

Stable Value Seen Less Risky in Aftermath of Financial Crisis

By Randy Myers

From an investor's standpoint, stable value funds have never been terribly risky. Their generally conservative investment approach and contract-value withdrawal guarantees have provided reliable performance. Yet now, in the wake of the most recent financial crisis, many stable value professionals believe their products have become even less risky.

"Not much has changed, but what has changed has been for the better," says Susan Graef, a principal and stable value manager with Vanguard Group.

Graef and four other panelists addressed participants at the 2011 SVIA Spring Seminar in April. They said the challenges the industry is facing, such as limited wrap capacity and pressure from wrap providers for tighter contract terms, reflect to some degree a reevaluation of risks that always existed in the stable value business—even if senior executives

continued on page 2

Stable Value Less Risky

continued from page 1

in the corporate offices didn't always appreciate them. "I would offer that the actual risks—the structural risks relating to our promise of benefit responsiveness—are actually less now than they were in the past," Graef said.

Other panelists agreed, noting that the industry has taken a number of measures to reduce risk.

"Whether you look at the duration of our investment portfolios or the credit quality of what we're holding, there have been a lot of changes for the good," said John Sturiale, managing director and head of Institutional Asset Management for Charles Schwab Investment Management. "We've also been conscientious on the liability side of the equation in terms of knowing who is investing in our fund. That's something we spend a lot of time on at Schwab, and we know wrap providers look at it closely, too. They want to know who owns the fund and what would happen if they pulled out."

Thomas Schuster, head of the Stable Value Investment Products Division for insurance company MetLife, where he serves as vice president in the Corporate Benefit Funding Group, said his company now includes more explicit investment guidelines in the wrap contracts it issues, particularly as they relate to sector constraints. He noted, though, that fund managers operating under wrap contracts that were put in place prior to the start of the financial crisis continue to operate under their original investment guidelines.

For all that stable value has endured over the past four years, George Quillan, vice president and actuary at Prudential Financial, suggested that the one risk not tested recently is the risk of rising interest rates. Such periods can have a negative impact for stable value funds if rates rise enough to overcome stable value funds' significant yield advantage over money markets. First, they reduce the market value of fixed income assets in stable value portfolios. Second, they can tempt investors to swap money out of stable value funds and into money market funds, which track interest rate changes more quickly. Accordingly, fund managers can find themselves forced to liquidate assets at depressed levels to meet redemption requests. That can negatively impact investors who stay in the fund, and in some cases could force wrap issuers to make good on their contracts.

While Graef noted that rising rates have not provoked a mass exodus from stable value funds in the past, Quillan said potentially rising interest rates remain, in his view, the biggest risk the industry faces.

"We're also concerned about the potential for rising rates," Schuster said. To address that concern, he said, MetLife carefully analyzes retirement plan demographics when underwriting new business and avoids taking on plans where the vast majority of participants are retirees focused primarily on generating income rather than growing capital. MetLife also has been shying away from providing wrap contracts for separate account funds where the retirement plan client has a money market fund as a core investment option. It avoids such deals, Schuster said, even if the plan has an equity wash rule designed to prohibit investors from swapping assets directly from a stable value fund into a money market fund when interest rates are rising. Investors can often work around those equity wash rules, he suggested.

The panelists generally agreed there are other measures stable value funds can take to hedge against a potential rising rate environment, including holding more cash in their portfolios to facilitate redemptions. "We're certainly looking at that differently than we did a year or two ago, when we didn't think we were as close to the end of this bottom on interest rates as we are today," said Schwab's Sturiale.

The panelists also generally agreed that they see slightly more risk in pooled funds, which cater to multiple retirement plans, than they do in separate account funds, which cater to a single plan. A key reason, Quillan said, is the 12-month "put" option that is common to pooled funds. Those options allow plans to exit their funds at contract value within a year of giving notice.

"I worry not only about the concentration risk of the largest plans in a pool but also about whether there is significant contagion risk," Quillan elaborated. He explained that if a number of plans exited the fund at approximately the same time, it could impact the probability of other plans wanting to exit, too.

Sturiale said he also worries about having any one consulting firm advising a large number of plan sponsors in a pooled fund. "If XYZ Consulting advises a large number of plans in our fund and turns sour on that fund, they could move their entire client base

continued on page 3

SVIA STABLE TIMES

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Weathering the Storm

continued from page 1

In fact, Mitchell noted, stable value returns have nearly matched those available from intermediate-term bond funds, not just recently but over the past 22 years. It has performed well by also insulating investors from increased volatility.

From the end of 1988 through the end of 2010, Mitchell said, a $1 investment in money market funds would have grown to $2.25, while a $1 investment in a model stable value account would have grown to $4.08. A comparable investment in the Barclays Intermediate Government/Credit Index would have grown only slightly more, to $4.34.

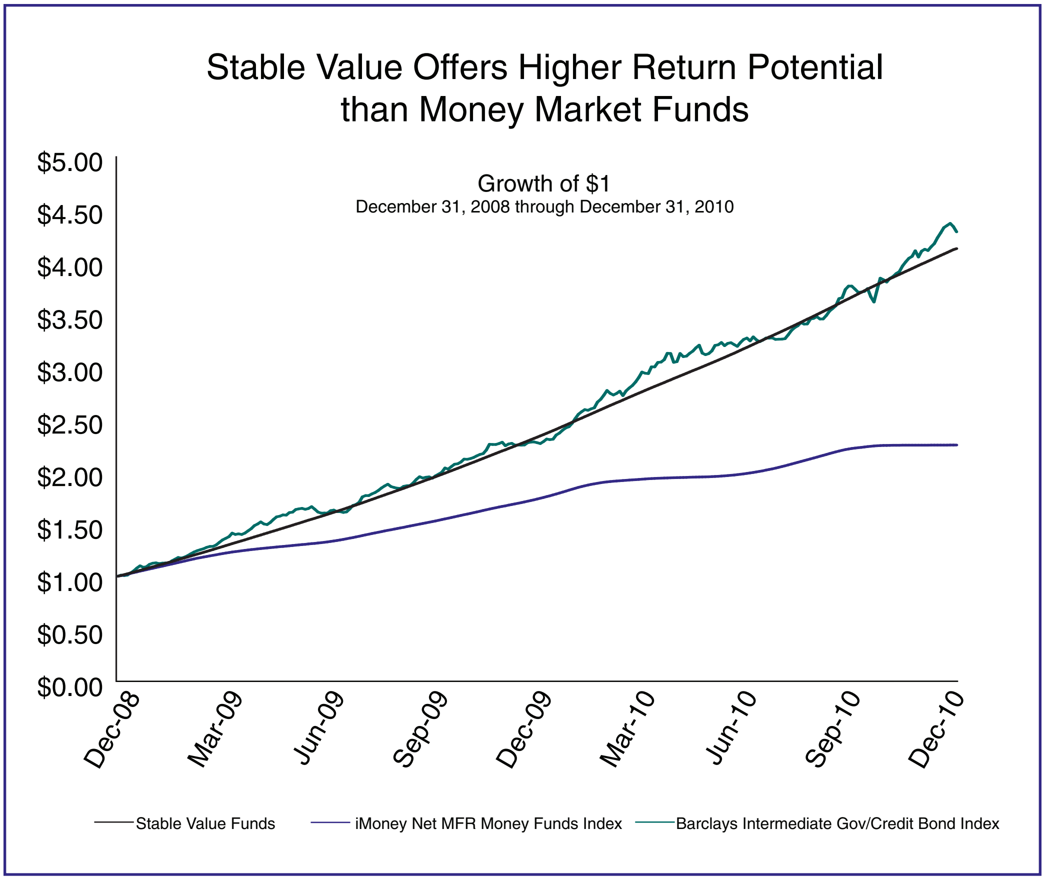
"Despite some skepticism, stable value has worked," Mitchell concluded. "Investors have reacted to this positively. They have sought out stable value funds and they have stayed in them." SVIA

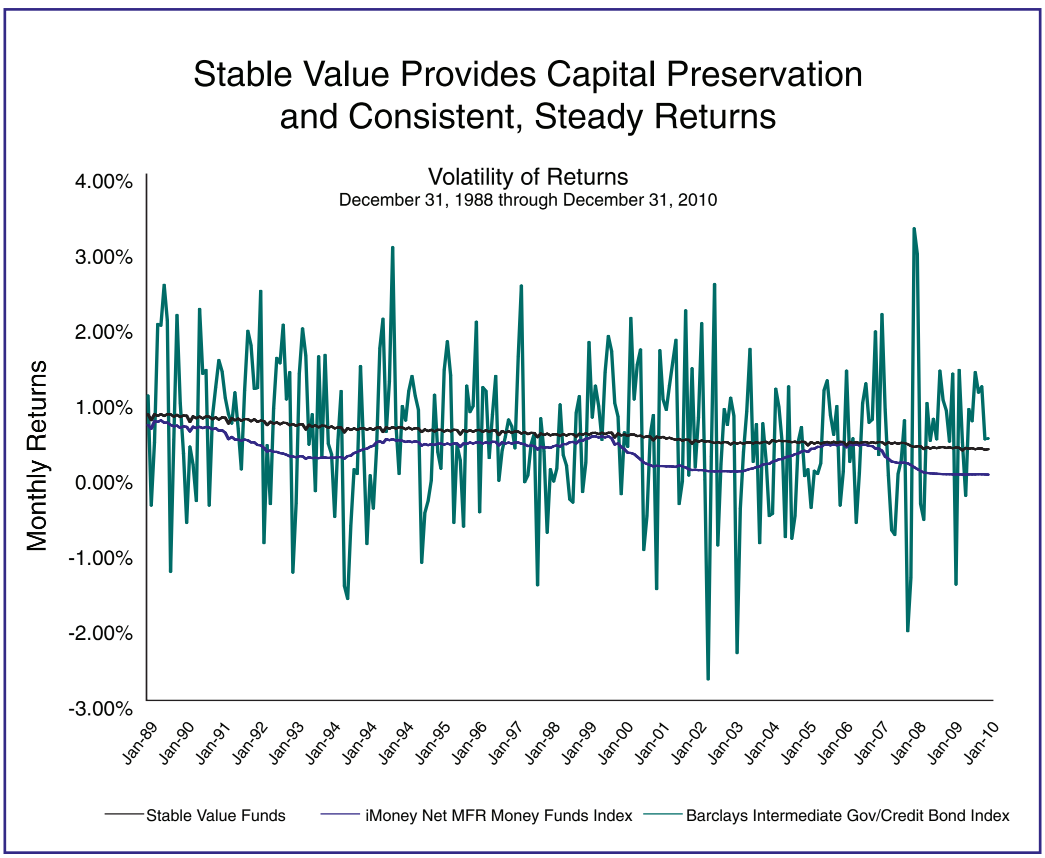
Stable Value Less Risky

continued from page 2

out at one time," he noted. "That's a risk that may not be looked at as closely as it should be."

Still, both Sturiale and Antonio Luna, vice president and fixed income portfolio manager with asset manager T. Rowe Price Group, noted that their pooled funds have had strong cash inflows lately, making it easier for them to hold extra cash if needed to meet any unusual redemption requests. It's just another example, panelists noted, of how risk has been further minimized in stable value. SVIA





Plan Sponsors Taking More Nuanced View of Stable Value

By Randy Myers

Stable value funds play an important role in defined contribution plans, where they account for approximately $520 billion of the money U.S. investors have saved for retirement. Still, in the wake of the most recent financial crisis, retirement plan sponsors are taking a closer look at which investment options should stay in their plans and which should go.

Stable value funds remain highly popular. Consulting firm Russell Investments recently polled a dozen of its large plan sponsor clients and found that 10 plans were satisfied with their stable value fund. They found only one plan that intended to eliminate its fund, while another was considering it.

One reason for stable value's enduring popularity is that it provided a safe haven during the turmoil of the recent financial crisis, generating steady, positive returns throughout the ordeal. Russell consultant Rod Bare said that by his firm's calculations, stable value funds have a compelling future as well, with a chance to generate returns averaging nearly 5 percent annually for the next 20 years, with less volatility than most other assets.

Plan sponsors do have concerns, Bare told participants at the SVIA 2011 Spring Seminar. Sponsors concerns are:

- Rising fees for stable value wrap contracts. Wrap contracts are the mechanisms that permit investors to transact at contract value under most circumstances, regardless of market conditions.

- More restrictive wrap contract provisions. Many of the newer provisions are aimed at making sure stable value fund managers invest their funds' assets conservatively. Others target when and how retirement plan participants can switch money into and out of stable value funds.

- The growing popularity of multi-asset-class investment options, such as target-date funds.

"Fund exit options also are a concern for pooled stable value funds," Bare said. In part to protect the interests of other investors in their funds, pooled stable value funds typically limit how quickly a retirement plan can withdraw from a fund. Plan sponsors sometimes balk at this restriction. "Some who have gotten rid of their stable value funds have been pretty vocal about their experiences in this regard," Bare said. "They attend conferences, and their peers seek them out for advice."

Taken together, Bare said, these issues can make it easier for overworked investment committees to decide to exit stable value.

Meanwhile, he noted, competition for stable value funds is increasing every day, with potential substitutes undergoing constant refinement. Plan sponsors are taking a closer look at target-date funds, he noted, particularly since they carry the Department of Labor's imprimatur as a "qualified default investment option," or QDIA, for plan participants who don't choose their own investments.

The stable value industry can help to maintain its important place in the retirement plan market, Bare suggested, by communicating more frequently and extensively with plan sponsors about the issues that concern them. He said the industry should address, for example, the reason that wrap fees have been increasing, so that sponsors don't mistakenly assume that issuers are simply taking advantage of a current dearth of wrap capacity to raise prices.

"I tell sponsors there are a lot of good things about stable value, and that just because wrap fees are going up five basis points is not, in itself, a reason to jettison a stable value fund right now," Bare noted. "I also point out that in some cases there is not really a good substitute for what a stable value fund provides."

In addition to educating plan sponsors on fees, Bare suggested the industry look for opportunities to introduce stable value products into new markets, such as health savings accounts. "Some people are contributing $3,000 to $5,000 a year into those accounts, and in a few years could have a decent amount of money in them," he said. Since investors do not know how soon they will need the assets in their HSAs, he said, they might appreciate having access to a product such as a stable value fund that could preserve their capital until it is needed.

Bare said the industry also should push harder to have stable value investments included in the portfolios of target-date funds.

Finally, Bare suggested, the industry should try to position stable value funds as a "retirement income bridge" for investors who are leaving the workforce and need a steady source of income. If they are not yet certain whether they want to annuitize their retirement nest eggs to generate that income, he said, stable value funds could act as a source of income and principal preservation while they sort out their options.

Wharton Professor Takes Financial Planning Models to Task

By Randy Myers

Wharton professor David Babbel has poked his head under the hood of a lot of financial planning models that purport to show investors their chances of having enough money to retire in old age. He doesn't particularly like what he's seen.

"The models have several flaws in them," Babbel told participants at the 2011 SVIA Spring Seminar. One of the biggest, he said, is an assumption that future investment returns will follow what mathematicians describe as "normal" distribution patterns.

Normal return patterns deviate from the mean in a neatly symmetrical fashion that creates a bell shape when plotted as a graph. The peak of the bell represents mean returns, while the lines forming the sides or "tails" of the bell on either side of the peak represent less frequent but more extreme returns.

Unfortunately, Babbell said, the chances of returns tracking that perfectly symmetrical bell shape in the real world are virtually nil. As a result, financial planning models make false inferences about future market activity and the odds of investors meeting their goals.

In fact, Babbel said, plotting historical stock market returns produces a bell shape that is shorter at its peak, with longer or "fatter" tails, than a normal return distribution would create. That means that in the real world, investors have had more opportunities to experience extreme returns. When registered on the downside of the curve, these tails have dramatically diminished an investor's chances of having a financially secure retirement.

Investors can minimize such risks, Babbel noted, by investing in products that are less subject to volatility than the stock market. He cited in particular annuities and stable value funds, both of which are backed by investment contracts or wraps.

Babbel has been conducting research on stable value funds for several years, initially under contract to the SVIA. Recently, he has continued that research on his own time, in part, he told participants at the SVIA Spring Seminar, because of his continued interest in the surprisingly favorable data his initial research has yielded.

For example, Babbel has calculated that stable value funds stochastically dominate a number of other asset classes, namely money market funds and some sectors of the fixed income market. That is something no other asset class can claim, he reminded Seminar participants. As a consequence, he reiterated, even moderately risk-averse investors should logically make stable value funds a substantial component of their investment portfolio, to the complete exclusion of money market funds and to the almost complete exclusion of government bonds and long-term corporate bonds.

Most financial planning models don't reach that conclusion. As Babbel sees it, that's a shortcoming of the models, not stable value funds. SVIA

Editor's Corner

Stable Value: Keeping Its Promises

By James King, Prudential Insurance

Stable value continues to perform well in the post-crisis world. However, the cloud of economic and regulatory uncertainty looms over all of us. To meet new challenges, we will need to adapt and change to succeed in this ever-evolving environment.

The 2011 SVIA Spring Seminar provided a good opportunity to reflect on today's financial realities and the need for guaranteed products in qualified DC plans. This issue of *Stable Times* reflects on diverse topics such as the need for lifetime income solutions in retirement plans, plan sponsors' take on stable value, and at the macro level, the U.S. economy and its debt level.

As we go through these times of uncertainty, I am confident that stable value will continue to deliver on its promises. Let's continue to bring transparency to the retirement market place and educate all stakeholders about the true value of stable value and the many contributions it makes as a major component of well-diversified retirement plans.

Proposed Fiduciary Regulations Could Prove Problematic for Broker-Dealers

By Randy Myers

You knew this was going to be tricky.

In the aftermath of the most recent financial crisis, Congress called for stiff new regulation of the financial services industry. Now, some of the regulations proposed by various federal agencies appear to conflict with those suggested by others.

Exhibit A is a proposal from the Commodities Futures Trading Commission (CFTC) under the Dodd-Frank Wall Street Reform and Consumer Protection Act. It says that when a firm recommends a swap transaction or trading strategy to a retirement plan or similar "special entity," the firm must act in the best interests of that plan.

On its face alone, the proposed rule seems troublesome, since a bank recommending or entering into a swap with a retirement plan would also be compensated for its role and potentially even serving as a counterparty in the transaction.

The CFTC apparently recognized this conundrum. In making its proposal, it said explicitly that the rule is not intended to preclude banks or other swap dealers from recommending a swap and then entering into that transaction with a client.

continued on page 6

Proposed Fiduciary Regulations Could Prove Problematic for Broker-Dealers

continued from page 5

If that weren't puzzling enough, the Department of Labor (DOL) issued proposed regulations in October that redefine the circumstances under which banks and other financial services firms would be deemed fiduciaries under the terms of the Employee Retirement Income Security Act, or ERISA, when giving investment advice. Attorney Donald Myers, a partner in the Washington, D.C., office of Morgan, Lewis & Bockius LLP, says it is possible to envision scenarios under the DOL and CFTC proposals in which a swap dealer might not be a fiduciary under CFTC rules but could be under ERISA.

"And if you are an ERISA fiduciary, you can't enter into a swap transaction with a plan that you are advising," Myers told participants at the 2011 SVIA Spring Seminar. "So you've got a real tension between the proposed CFTC and DOL regulations."

To further complicate matters, Myers noted that the Securities & Exchange Commission, also acting under the auspices of Dodd-Frank, recently recommended establishing a uniform fiduciary standard for broker-dealers that would align with the standard that now exists for registered investment advisors. Under current law, broker-dealers are not, in most circumstances, subject to fiduciary duty requirements under federal securities laws.

Myers said the Department of Labor has received more than 200 public comments on its proposed regulations. The biggest complaints have come from the brokerage industry, he noted, which worries that if a broker-dealer is classified as a fiduciary, it will be unable to receive compensation for recommendations it makes, not only to retirement plans but also to participants in those plans.

Retirement plan record-keepers that maintain call centers and field inquiries from plan participants also worry that some of those conversations could be viewed as constituting investment advice, Myers said, leaving them open to the possibility of violating fiduciary standards.

Many commenters on the DOL proposal have suggested that before it proceeds any further, it should coordinate its efforts with the SEC to minimize potential conflicts between their new standards.

"I'm not quite sure how this is going to get worked out," Myers said, "but it is a good example of having three agencies all believing that the solution to any problem in life is to make someone a fiduciary, ensuring they'll be subject to a higher standard and potential liability if they do something wrong." SVIA

Economist Says Debt of "Bankrupt" United States Far Worse than Advertised

By Randy Myers

Officially, the federal debt held by the U.S. public is a staggering $9 trillion. Other popular calculations place the federal debt at just over $14 trillion. In fact, says Boston University economics professor Laurence Kotlikoff, the real number is far, far higher—about $202 trillion.

"The United States is bankrupt," Kotlikoff told participants at the 2011 SVIA Spring Seminar. "The official debt doesn't capture most of the action when it comes to our fiscal problems because most of our obligations are unofficial. We've been looking at these debt numbers and taking them seriously, and they're not really telling us the whole story."

Kotlikoff, the author of *Jimmy Stewart is Dead* (John Wiley and Sons, 2010), which charts a course for reforming the global banking system, attributes the discrepancy between the official federal debt and the true federal debt to semantics. Government accounting policy, he said, masks the country's financial health by excluding from the debt many of its future liabilities, including those associated with programs such as Medicare, Medicaid, and Social Security.

A better way to measure the debt, Kotlikoff argues, is by calculating the present value of all projected government spending, excluding only interest expense, less all projected tax revenues. That is how he arrived at the $202 trillion figure, which he calls the "fiscal gap."

To put the fiscal gap into perspective, the United States is on an untenable track even by conventional definitions of the federal debt. Extrapolating from the long-term projections of the Congressional Budget Office, Kotlikoff said, the debt-to-GDP ratio of the United States, which was 62 percent at the end of fiscal 2010, will exceed 90 percent in 2017. That's four years earlier than a similar analysis had suggested just nine months before.

What's more, a study of the most traumatic financial crises over the past eight centuries by economists Ken Rogoff and Carmen Reinhart has shown that once a country's debt-to-GDP ratio exceeds 90 percent, countries get into trouble. "They don't grow as fast, they have financial crises, they can't borrow at the rates at which they had been borrowing," he said.

He noted that Greece, to cite just one current example, has a debt-to-GDP ratio of about 120 percent right now.

The U.S. debt has ballooned into crisis territory, Kotlikoff said, in part because the country for decades has been transferring wealth from younger to older Americans through social

continued on page 7

Incorporating Lifetime Income Options in 401(k) Plans

By Randy Myers

Retirement plan sponsors have been slow to embrace them, but financial services firms continue to roll out lifetime income products for the 401(k) market.

These new products are designed to help retirement plan participants generate a steady stream of income in retirement, much as they would if they converted their nest egg into an annuity. These new products are considered especially timely in the wake of the most recent financial crisis, particularly in light of the diminishing effect of those challenged by the markets in almost all investment accounts , which is especially worrisome for many recent retirees and those nearing retirement.

To date, the new products have typically taken one of two forms, Paul French, portfolio strategist for Diversified Investment Advisors, an investment advisory firm specializing in retirement plans, told participants at the 2011 SVIA Spring Seminar. One approach wraps a guaranteed minimum withdrawal benefit, or GMWB, around an underlying investment, usually a target-date or asset-allocation mutual fund. The other takes the form of an in-plan version of a traditional deferred fixed annuity.

With GMWB-based products, lifetime income payouts generally begin at a particular retirement year and equal a percentage of the participant's guaranteed income "base." That base is established with the participant's first contribution to the product and increases with additional contributions. It cannot go down in value if the participant does not take withdrawals beyond the specified amount. It typically resets to an even higher value at periodic intervals if the account's market value goes up. Payouts are expressed as a percentage of the benefit base and are usually higher the older the participant is when withdrawals begin.

Companies offering products in this space, French said, include Prudential, John Hancock, Transamerica, Milliman, Great-West, and AllianceBernstein. Diversified Investment Advisors also has launched one.

With the annuity-based, fixed products, a participant's contributions are typically invested in the issuing insurance company's general account. The contributions are used to purchase a future guaranteed income stream based on the amount of the contributions, the annuity purchase rate, the participant's age at the time of contribution, and the participant's age when they start taking income. Income distributions can start at any time subject to plan rules and are sometimes available with cost-of-living adjustment riders.

Companies offering annuity products, French said, include Hartford, MetLife, BlackRock, and Mutual of Omaha.

French said all of these guaranteed minimum products have been designed to let retirement plan participants lock in a minimum level of retirement income while still participating in the broader financial markets as well as to guarantee that income regardless of how long their principal lasts or how long they or their spouse lives. They're often viewed, he noted, as a way to help participants replace income that in years past might have been provided by defined benefit plans.

continued on page 8

Economist Says Debt of "Bankrupt" United States Far Worse than Advertised

continued from page 6

programs. This has robbed the young of the ability to save. In 1965, he noted, the domestic savings rate was about 15 percent; in 2009 it was -1.7 percent. "This is just a chain letter, a Ponzi scheme," Kotlikoff said. "But it's a big-time Ponzi scheme, much more sophisticated than anything (convicted financier Bernard) Madoff could have come up with."

The country's lack of savings has led to a lack of investment, Kotlikoff added, which has held back productivity improvements and resulted in decades of stagnant wages in real, or inflation-adjusted, terms.

Kotlikoff observed that closing the fiscal gap simply by raising federal government revenues would require an immediate and permanent 77 percent increase in every federal tax, including corporate and personal income taxes, FICA taxes, excise taxes, and estate and gift taxes.

As that solution would be untenable to just about everyone, Kotlikoff said the only workable alternative is immediate radical reform not only of the tax code but also of healthcare, entitlement programs, and the nation's financial system.

He has personally laid out roadmaps to two such reforms. On the healthcare front, he has proposed a progressive voucher system that he says is much like the ones used in Germany, Switzerland, Israel, and Holland. It is also similar to the one described in the recent 2012 budget proposal from Rep. Paul Ryan of Wisconsin, chair of the House Budget Committee.

Kotlikoff has also proposed creating a "limited-purpose" banking system, modeled on the mutual fund industry, in which banks would not hold loans and consequently would not be exposed to default risk. Instead, they would sell their loans to the public in much the same way mutual fund companies sell shares of their funds to the public. Under this model, banks also would be required to hold 100 percent reserves against checking account deposits.

Stable Value and the Dodd-Frank Act: An Update

By Randy Myers

Are stable value wrap contracts swaps? If so, should they be subject to more federal regulation?

The stable value industry argues that answer to the first question is no, making the second question moot.

Federal regulators are undecided.

Under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, a study group formed by the Securities & Exchange Commission (SEC) and the Commodities Futures Trading Commission (CFTC) is trying to decide whether a stable value wrap contract qualifies as a swap under the terms of the Act. (See "Swap or Not? Regulators Assess Stable Value under Dodd-Frank Act," *Stable Times*, volume 14, issue 2.)

If the SEC and CFTC conclude that a wrap contract is a swap, the stable value industry could be hit with new clearing and reporting requirements. However, the regulators also have the option under Dodd-Frank of deciding that even if a wrap contract is a swap, stable value funds should be exempted from Dodd-Frank oversight.

Attorney Anthony Mansfield, a partner with the firm of Cadwalader, Wickersham & Taft LLP, told participants at the 2011 SVIA Spring Seminar that regulators may ultimately choose to go the second route. Otherwise, he said, the financial services industry might be encouraged to push for similar treatment of other financial instruments, making it difficult to achieve what Congress intended under the Act.

The SVIA has been trying to position itself as a resource for the stable value study group, said Mansfield, who has been advising the organization, noting that "the more information we can provide, the better outcome we can anticipate."

Dodd-Frank gave the study group until October of this year to complete its work. However, the sheer number of regulations required by the new law have put regulators woefully behind the Act's scheduled deadlines, including the stable value study. The study team will most likely release a series of questions for public comment sometime late this summer, which follows the Commission's epic release in May of a 300-page swap definition.

The stable value study group could come out with its own notice of proposed rule-making and then invite public comment too, Mansfield noted, or it could issue an "advanced notice" inviting public comment prior to rule-making. He did not predict which was more likely.

There is, Mansfield noted, an outside chance that nothing will come of any of this if the U.S. House of Representatives, now controlled by Republicans, tries to slow down implementation of Dodd-Frank. Many House Republicans elected last year have expressed reservations about the Act and its costs, he said, and have mused about the possibility of revising it. "It would be a difficult thing to do," Mansfield said, "but it's lurking."

Alternatively, he noted, Republicans could try to starve the SEC and CFTC of the resources they need to implement the Act. The CFTC has said, for example, that it will need hundreds of millions of dollars in additional resources to carry out its Dodd-Frank mandates.

The fiscal 2011 budget approved by Congress shortly after the Spring Seminar didn't go that far in awarding additional funds, but it did add $34 million to the CFTC budget and $74 million to the SEC budget.

If regulators do find themselves having to pick and choose projects due to budget constraints, Mansfield said, it seems likely that the stable value initiative might be put on a back burner since it was not identified as a high priority under the Dodd-Frank Act. Absent a resolution of the matter, he said, the industry would take the position that stable value funds are not subject to additional regulation under Dodd-Frank until and if regulators say otherwise.

"The longer the delay, the longer we are definitely out," Mansfield said. "We are not in until they reach some sort of conclusion." SVIA

Incorporating Lifetime Income Options in 401(k) Plans

continued from page 7

Despite the advantages offered by these new income products, French conceded that many plan sponsors have yet to embrace them, concerned that they add an extra layer of fiduciary responsibility with respect to the underlying insurance feature. If and when the Departments of the Treasury and Labor (DOL) issue additional guidance on that subject, he said, it could pave the way for greater acceptance.

"I think the DOL is for the most part receptive to this product," French said. "They want to make it easier for sponsors to add this to their plans."

A few other issues are depressing adoption rates, he said. These include the need to educate participants about how and why they might want to use the products, and concerns about the products' lack of portability. In most cases, an investor wanting to take one of these products out of their retirement plan today could move it only into an IRA offered by the product's issuer.

French added that while the jury is still out on whether lifetime income products and stable value funds could coexist within 401(k) plans, the new products could be seen as competition to the principal protection guarantee that stable value products provide. SVIA

Stable Value Statistics

By Gina Mitchell, SVIA

Plan sponsors and 401(k) investors want to know the "numbers" to determine how their stable value fund stands up to other stable value funds and other investments options. SVIA has just completed work on two major surveys, which are a benefit of Association membership, that provide pertinent stable value statistics.

SVIA's Stable Value Funds' Quarterly Characteristics Survey tracks 25 major stable value managers on key data points such as assets under management, crediting rates, portfolio duration, portfolio credit quality and market to contract ratios over 10 quarters (December 2008 through March 2011). The Assets Under Management & Crediting Rates Chart demonstrates that stable value funds have kept their promise of capital preservation and consistent, positive returns that exceed money market funds throughout the financial crisis and continued recession.

SVIA's 15th Annual Stable Value Fund Investment and Policy Survey covers almost $540 billion in stable value assets through December 31, 2010. This survey looks at stable value funds from the three major management sectors: individually managed funds, pooled funds, and life insurance funds.

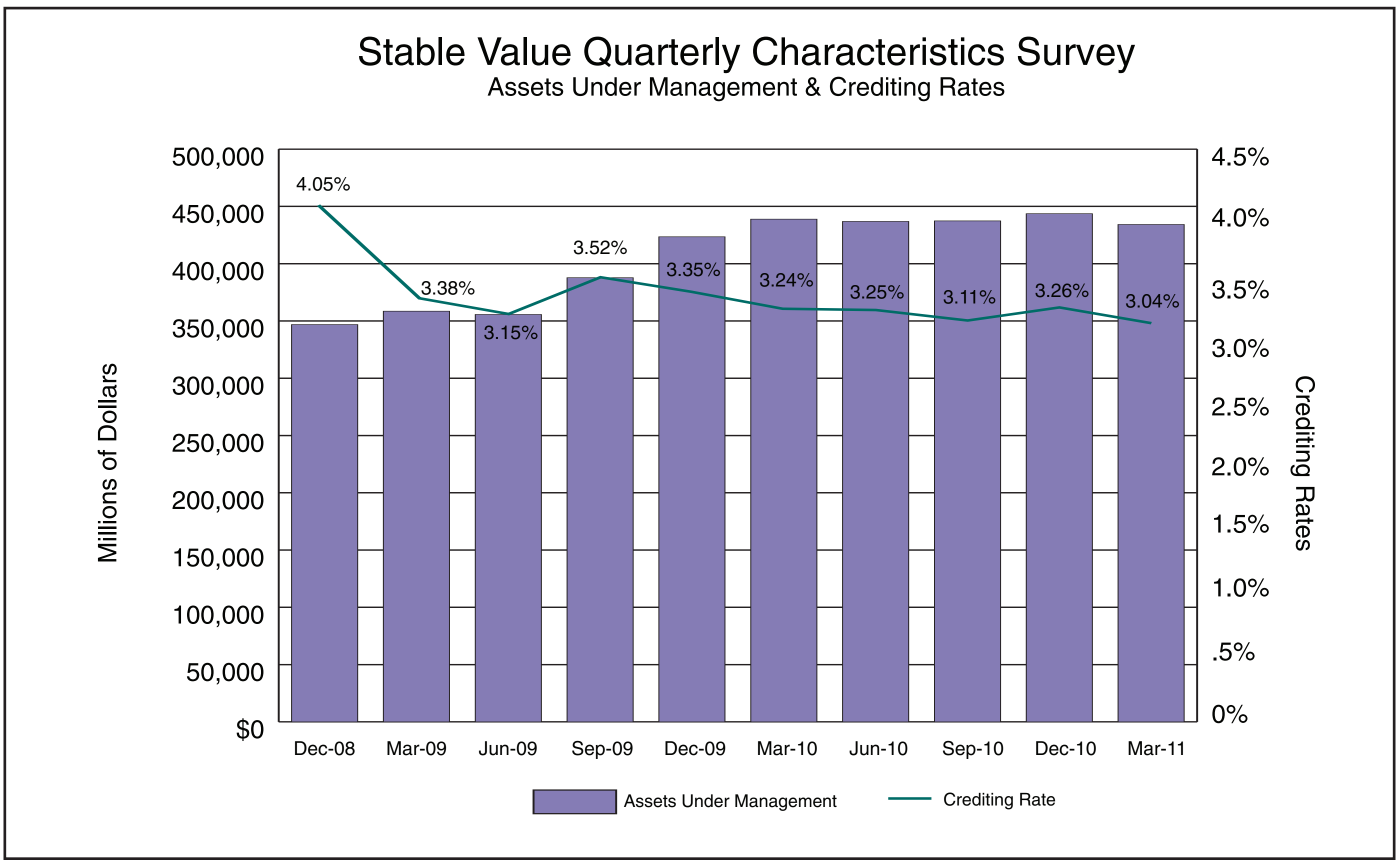
As the Stable Value Assets Under Management & Crediting Rates Chart illustrates, stable value assets have grown every year since 2005 except two. However, much of the variation in assets under management can be attributed to changes in survey participation. For example, in 2008 a very large manager began its participation in the survey. Conversely, in 2010 a few managers did not participate in the survey that had done so in previous years.

Further, the plans that offer stable value funds are predominantly defined contribution plans (92.34%), with 401(k) plans representing the majority of these assets at 62.02%.

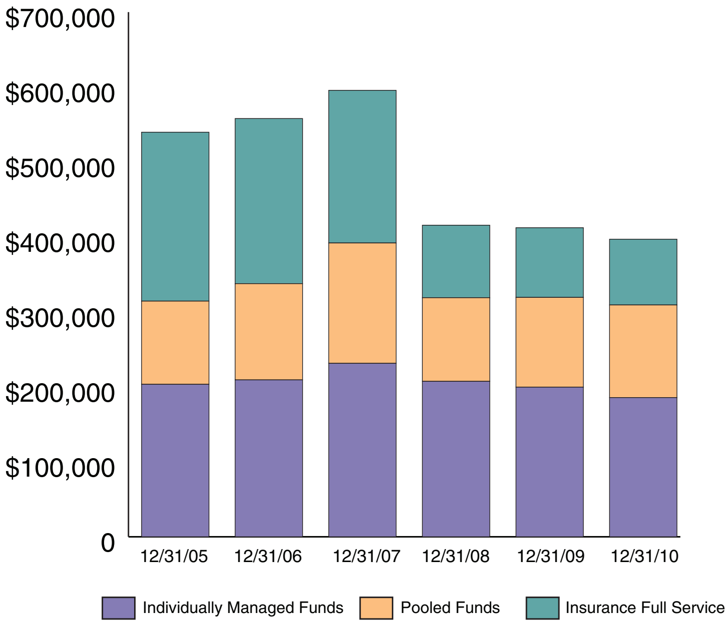
The 15th Annual Survey found that the weighted average duration for all three management segments increased to four years in 2010, mainly due to growth in the life full service and a lengthening of the life full service's duration to 5.42 as explained in the Modified Duration Chart.

The Contract Allocation Chart illustrates another important data point that the Annual Survey provides SVIA members. The chart shows how the three major management sectors have dealt with capacity concerns by reallocating Cash/Short Term Instruments, GICs, General Account Products, and Wrapped Assets.

To learn more about these two important surveys, please visit the Survey Section in Members' Only at www.stablevalue.org.

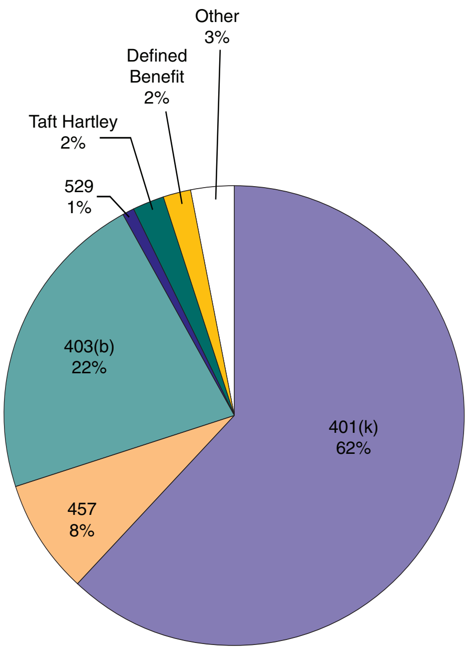


Stable Value Assets Under Management



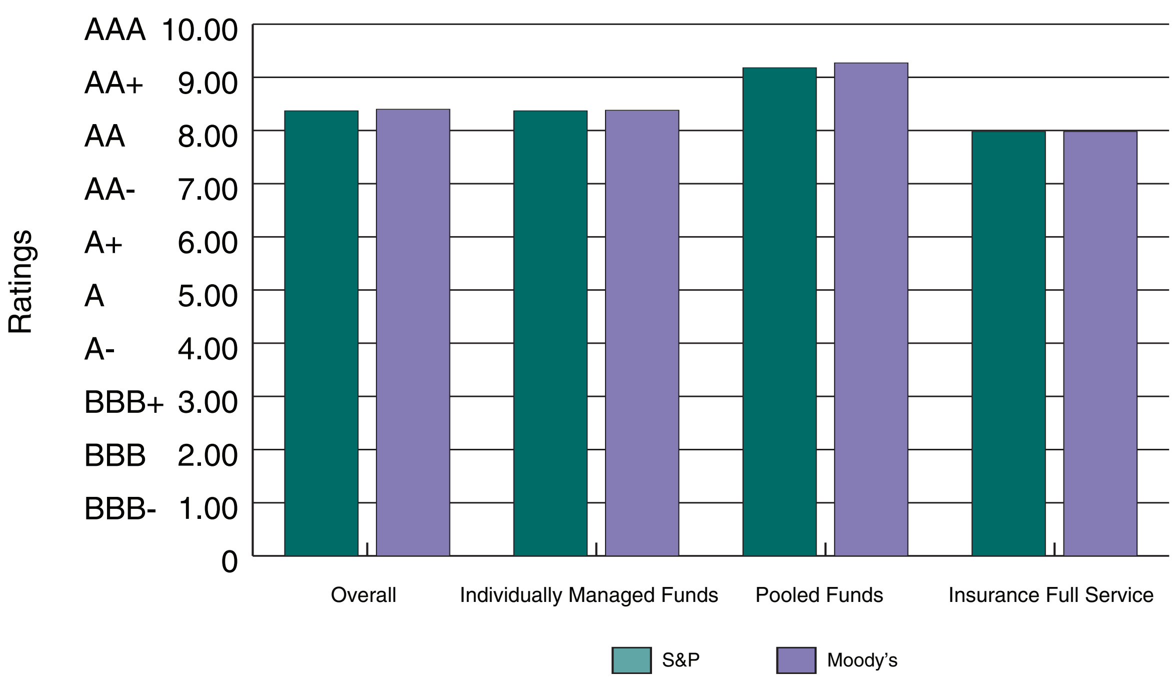
Source: SVIA Stable Value Fund Investment and Policy Survey from 2005 to 2010. Some changes may represent a change in survey participation, rather than a change in investment or policy trend.

Types of Deferred Savings Plans Invested in Stable Value

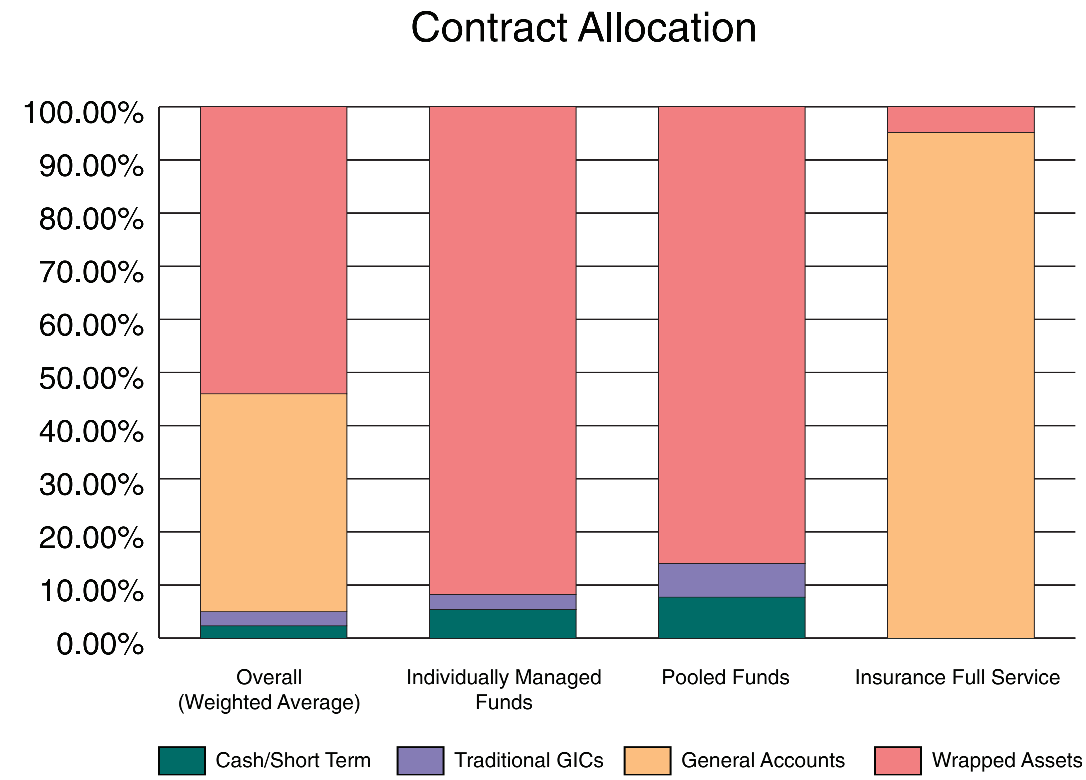


Source: SVIA 15th Annual Stable Value Fund Investment and Policy Survey.

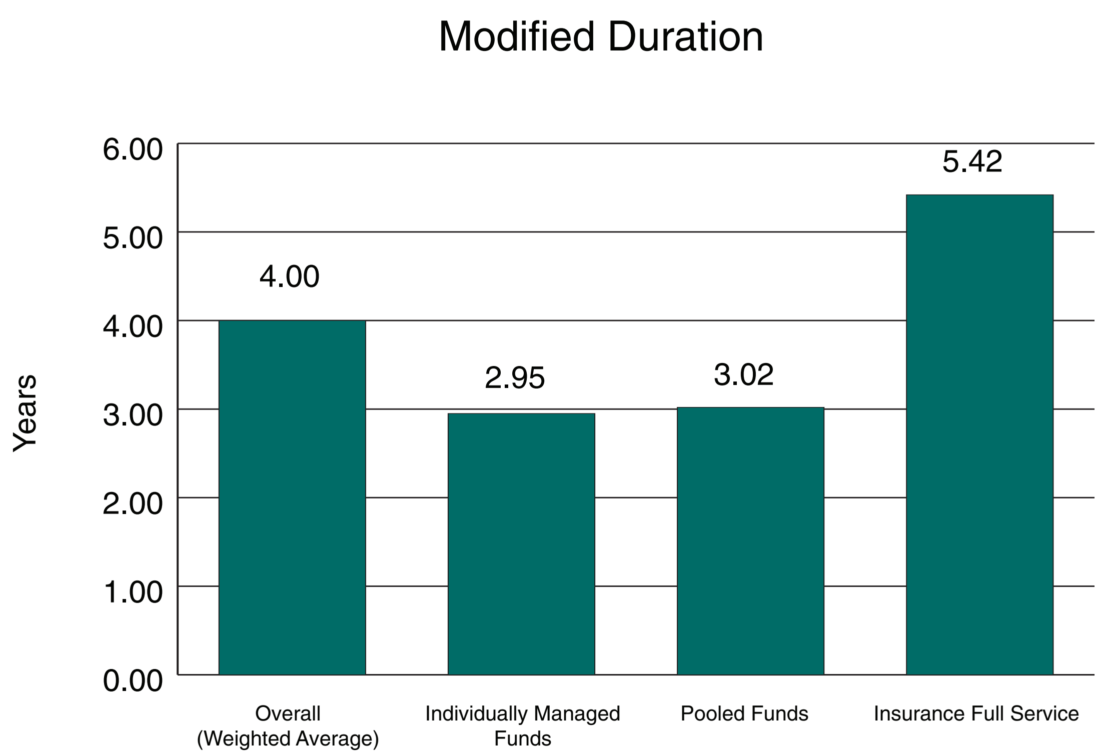
Overall Portfolio Credit Quality



Source: SVIA 15th Annual Stable Value Fund Investment and Policy Survey.



Source: SVIA 15th Annual Stable Value Fund Investment and Policy Survey.



Source: SVIA 15th Annual Stable Value Fund Investment and Policy Survey.

Stable Value: A Return to Roots?

By Randy Myers

In the wake of the financial crisis, some stable value products popular decades ago are coming back into vogue.

Insurance company–issued guaranteed investment contracts, or GICs, as well as a variety of similar guaranteed products, were at the height of their popularity through the 1980s. The guarantees provided by GICs were backed by the full faith and credit of the insurance company. And, in turn, the insurer invested contract proceeds in its own General Account. The insurance company owned the underlying General Account investments, and any returns from those investments accrued to the benefit of the insurance company while it typically paid fixed interest rates to contract holders.

Following the 1991 collapse of Executive Life Insurance Company, which had been a big issuer of GICs, the insurance industry began to offer "Separate Account GIC" (SAGIC) products as an alternative to traditional GICs. In SAGICs, the contract deposits were invested in investment pools separate and distinct from the insurer's General Account. Typically, the SAGIC investor received, over time, the returns generated in the insurer's separate account, subject to performance and liquidity guarantees from the insurer. This product essentially unbundled the investment management and insurance guarantee functions of the traditional GIC, and made them available as a package – but viewed separately – to investors. In the SAGIC products, the insurance company separate account still held title to the underlying product investments, while returns from those investments eventually accrued to investors rather than to the insurance company.

Also in the 1990s, the unbundling concept of SAGICs got extended even further. This time, the evolving product design provided that the underlying assets are owned by the plan/trust rather than by the insurance company (in the General Account for GICs, or in the separate account for SAGICs). This new product had an insurance guarantee function provided by a contract issuer similar to that provided by the GIC or SAGIC issuer. The original issuers of these new products were banks, although eventually insurance companies began issuing similar contracts as well. Originally, this product involved placing a single bond –owned by the plan/trust – and attaching the new contract to that bond. Typically, that bond was held to maturity and was replaced by a new bond at that point. This new product has been called a variety of trade names, but a common one is "Synthetic GIC," reflecting that it functionally works much like the traditional GIC. The contract itself is often referred to as a "wrap contract," as it "wraps" around underlying investments.

The essential advantages of SAGICs and Synthetic GICs were two-fold: If the guarantor failed, the plan would still own the underlying investments (separate account units for SAGICs, or bonds for Synthetic GICs); they also give more control over the management of the underlying assets. Plan sponsors and stable value managers began to migrate to synthetic GICs, which were viewed as less risky.

In the 2000s, industry product design began shifting again, this time to include not just individual bonds inside Synthetic GICs but also use of fixed income collective trust funds as the underlying contract investments. The use of fixed income collective trust funds instead of individual bonds provided greater degrees of asset diversification for plans of all sizes. This practice also provided vehicles for use of outside sub-advisors for style diversification. As Synthetic GICs took hold as a dominant product design, SAGIC growth slowed significantly.

Throughout stable value's history, there have been both single-plan stable value accounts and pooled stable value accounts. In pooled stable value accounts, many smaller plans can participant to get the benefits of diversification. All of the investment products noted above (GICs, SAGICS, Synthetic GICs) have been used in single-plan and pooled stable value account management

The recent financial crisis never touched the stable value industry the way the Executive Life debacle did. Indeed, stable value funds continued to generate steady, positive returns throughout the latest period of market turmoil. Still, the crisis prompted many in the stable value industry to reassess the risks associated with their products. In this environment, GICs, and especially separate account GICs, have begun to find new favor.

"We've had a sea change," Stephen LeLaurin, senior client portfolio manager for INVESCO Advisors, told participants at the 2011 SVIA Spring Seminar. "We're coming back to where things were many years ago."

MetLife is one insurance company that never left the separate account GIC business, and it has been a beneficiary of the product's revival. Warren Howe, managing sales director for the company, presented data at the Spring Seminar indicating that in 2006, their SAGIC product (called MetManagedGIC) accounted for a little less than half its $20 billion-plus in stable value business. By 2010, the separate account GIC business had more than doubled to over $20 billion and now accounted for about two-thirds of MetLife's total stable value business.

Other facets of the stable value business also show signs of returning to the industry's roots, LeLaurin and other industry executives told Seminar participants. Wrap fees, for example, which had fallen precipitously over the past couple of decades, are climbing higher again, noted Karl Tourville, managing partner at

continued on page 13

Stable Value: A Return to Roots?

continued from page 12

Galliard Capital Management. Also, he said, commingled or pooled funds have been shortening the duration of their underlying fixed income portfolios.

"Historically, durations were about 2.8 years," he said. "They're now averaging about 2.5. We think they could go down to 2.2 years. That, incidentally, was the duration of collective funds in the mid-to-late 1980s, when we used to run five-year laddered GIC funds."

Tourville noted that pooled funds remain popular among smaller retirement plans. "Pooled funds started in the early 1980s and two decades ago might have had $20 billion in assets," he said. "Today there is probably at least $125 billion and perhaps more than $150 billion in collective pooled funds. We're seeing, in some ways, more demand for them than ever."

Meeting that demand has become a challenge, however, as some wrap issuers have exited the wrap business or cut back their appetite for it in the wake of the financial crisis. While a few new players have entered the market recently, industry insiders say still more capacity is needed.

Robert Whiteford, managing director in the Pension/Insurance Derivatives Products Group at Bank of America, noted that wrap issuers historically have liked the pooled fund business, primarily for the diversification benefits it provided. He also cited the presence of "tens or hundreds of thousands of plan participants in a single fund making individual decisions," often diversified by company sector and geography.

"These were all good things," Whiteford said. "In fact, we traditionally viewed pools as less risky than separate accounts."

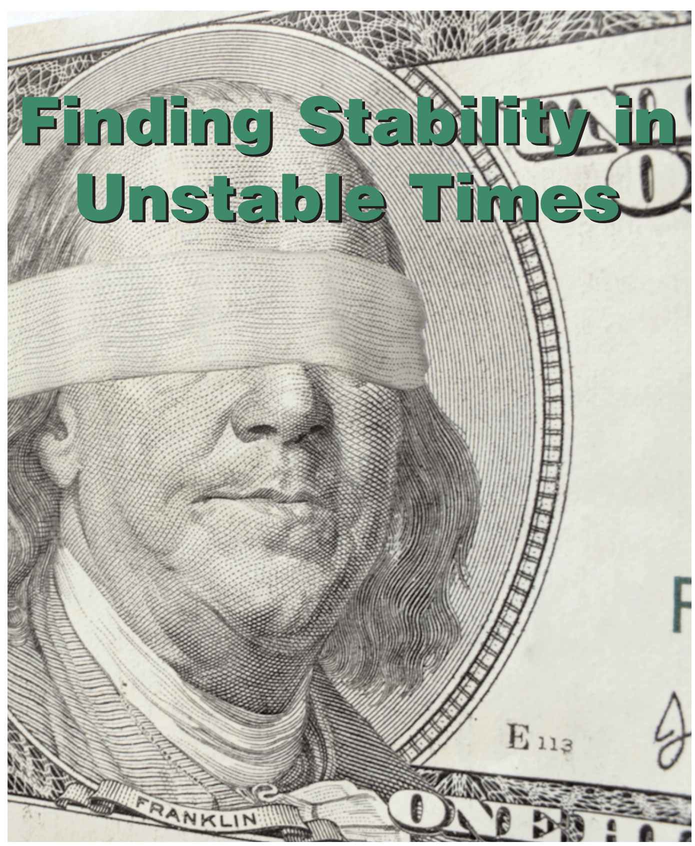
But that view, too, has evolved. During the financial crisis, Whiteford said, wrap issuers discovered that there was greater "concentration risk" in pooled funds than they had previously recognized. Many pooled funds, he said, had a few large retirement plans in them that could decide on short notice to exit the funds, typically over 12 months. Mass withdrawals can be difficult for funds to manage efficiently, especially if they occur when the market value of a fund's assets is below contract value. In that situation, the remaining pooled fund must bear the financial consequences of paying contract value to departing plans when market value is lower. In the extreme scenario of an entire pooled fund winding down through plan withdrawals when market is less than book, wrap issuers could be on the hook to make up the difference.

Whiteford noted that investment performance among pooled funds varied significantly during the crisis as well, which prompted some retirement plans to shift money from one fund to another more than had been common in the past. In some cases, they acted on the advice of consultants. "We saw transfers of assets from one manager to another in a way we never saw before," Whiteford said.

While insisting that wrap providers recognize the social benefits of pooled funds, Whiteford also exhorted those funds to take measures to encourage new wrap capacity. They can do that, he said, by ensuring greater plan sponsor diversification in their funds and by continuing to produce safe, steady returns. "I think in the past the mantra, too much, was yield," he said. "Now it should be safety. This is a safety product, and that is what people should focus on first."

LeLaurin added that a vibrant pooled fund business is critical to the stable value industry itself. Despite the fact that most of the managed stable value assets in the industry is held in single-plan accounts, he noted that the overwhelming preponderance of retirement plans in the United States—perhaps as many as two-thirds—use pooled funds to offer stable value to their participants. Smaller plans are most heavily represented in that group.

"If we don't have a vibrant pooled fund environment and community, then we're not serving the vast bulk of the plans in the United States," LeLaurin said. "In fact, some people would argue that without pooled funds, the stable value industry can't exist. It's not likely that regulators would be happy about allowing stable value to hang around just for large plans." SVIA



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