// SVIA STABLE TIMES

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Debt and Deficit Crisis: Navigating the Realities of a Deleveraging World

By Randy Myers

The 2008 housing bust and credit crisis may be fading into the rearview mirror of history, but they are continuing to drive developments in financial markets and much of the global economy. After triggering what has been termed the Great Recession, the financial market crisis has left the developed world contending with what might be called the Great Deleveraging—a monumental process of debt reduction. It is a process, Christine Hurtsellers told participants at the 2011 Stable Value Fall Forum, that is in its early stages.

Hurtsellers is chief investment officer for fixed income and proprietary investments at ING Investment Management, which manages about $163 billion for institutions and individual investors. She said the current deleveraging process will take a long time, in part because it is global in nature and in part because developed-economy governments and the private sector alike piled on such massive amounts of debt and leverage for more than a decade leading up to the financial crisis. Sovereign debt-to-GDP ratios are now at historic highs and expected to rise even further, particularly in the

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The Federal Budget: David Walker Lays Out Hard Choices for a Sustainable Future

By Randy Myers

To some, Washington's inability to come up with a meaningful plan to reduce the federal debt is evidence of political gridlock. To David Walker, Comptroller General of the United States and head of the U.S. Government Accountability Office from 1998 to 2008, it's just another sign that the United States has become a dysfunctional democracy no longer representative of, or responsive to, the public.

Walker, now CEO of the Comeback America Initiative, a non-profit organization he founded to promote fiscally responsible government, seldom pulls punches when he describes the economic challenges facing the country. He didn't disappoint in a talk before the SVIA at its 2011 Fall Forum in November.

"We need policy, operational, and political reforms to revitalize our democracy and make some tough choices so that we can keep America great," Walker told forum participants. "We've strayed from some of the key principles and values on which our

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The 2012 Elections: Time for a Change?

By Randy Myers

Among political truisms, few are more trusted than this one: presidents do not get reelected when the economy is weak and unemployment is high. However, warns public opinion pollster Gary Langer of Langer Research Associates, anything may be possible in 2012.

The economic outlook was clearly weighing against President Barack Obama's reelection hopes as 2011 drew to a close. The nation's Gross Domestic Product was expanding at a sluggish pace, and unemployment remained near 9 percent more than two years after the official end of the last recession. By some measures, the unemployment situation was even worse than it appeared, Langer told participants at the SVIA Fall Forum in October. Factoring in discouraged workers who had settled for part-time jobs, for example, one in six Americans weren't able to get the kind of work they wanted, making this the worst labor market since the Great Depression.

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The Federal Budget: David Walker Lays Out Hard Choices for a Sustainable Future

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xcountry was founded, including limited but effective government, individual liberty and opportunity, personal responsibility and accountability, rule of law and equal justice under the law, fiscal responsibility, and intergenerational equity."

Walker told his audience that the federal government now accounts for 24 percent of the U.S. economy and is headed to 37 percent, absent a change in course. "If you add state and local governments, government would be over 50 percent of the economy by 2040," he said. "Government is not the engine of growth, innovation, and job creation; this cannot be allowed to happen."

While government spending was once dominated by the defense budget, Walker said, it is now dominated by social programs, most aimed at senior citizens. As the great mass of Baby Boomers born between 1946 and 1964 begins retiring, he said, the associated "tsunami of spending" will compound the nation's fiscal problems, which he laid at the feet of both political parties. "Spending has been a problem for a while, but it went out of control over the last 11 years," he said. "Both parties are responsible, and both have to be part of the solution."

Walker said the United States is already worse off than some of the countries that routinely make headlines for their fiscal problems. For example, he said, "We're less than three years from where Greece was when it had its crisis, when you count what we owe Social Security and Medicare."

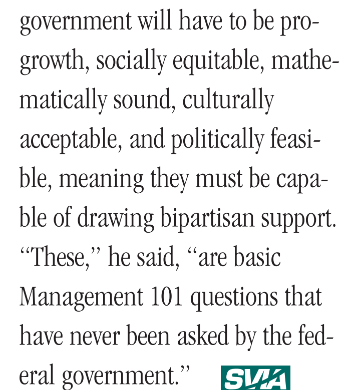
Walker explained that by the end of fiscal 2010, U.S. federal debt had ballooned to $14.8 trillion, exceeding the country's Gross Domestic Product (GDP) for that year, which came in at $14.5 trillion. Once debt exceeds 90 percent of GDP, he warned, it starts to become a drag on economic growth. Yet over the next decade, he said, the U.S. debt could grow another $10 trillion if changes aren't made to the federal budget.

The rub, he insisted, is that there is plenty of room to cut spending. He noted, for example, that the United States already spends double what other countries spend per person on healthcare and K-12 education. It also spends as much on defense as the next 14 nations combined. "We have plenty of opportunity to reduce defense spending without compromising security," he said. "It's one of the most bloated bureaucracies around."

Walker said there's also an argument to be made for raising additional tax revenues, in part because 51 percent of individual tax filers already pay no federal income taxes at all. "We need more people pulling the wagon," he urged.

To begin whittling down the federal debt, Walker said Washington should pursue several initiatives: rationalizing the government's healthcare promises to the citizenry, reducing defense spending without compromising security, and overhauling the tax code to create a simpler, fairer, and more competitive tax environment. "My view is that we need three parts spending reductions and one part revenue enhancement," he said. "You can't grow your way out of this problem, you can't inflate your way out, and you can't just cut your way out in terms of spending, or tax your way out. It's math."

Walker cautioned that to succeed, any actions taken by the government will have to be pro-growth, socially equitable, mathematically sound, culturally acceptable, and politically feasible, meaning they must be capable of drawing bipartisan support. "These," he said, "are basic Management 101 questions that have never been asked by the federal government." SVIA



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Debt and Deficit Crisis: Navigating the Realities of a Deleveraging World

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developed economies, as governments continue to borrow to finance crisis-related stimulus programs.

In the midst of such negative news, many investors have sought shelter in the safety of U.S. Treasury bonds, which, at the long end of the yield curve, generated total returns of about 25 percent through the first 11 months of 2011.

That flight to safety was not surprising given past history, Hurtsellers noted. She cited a study by the consulting firm of McKinsey & Co. of 45 previous deleveraging episodes, 32 of which followed a financial crisis. The typical characteristics, she said, included belt-tightening by developed markets for about half a dozen years, accompanied by a recession. Households tended to save more and businesses tended to invest less, slowing economic growth. Governments devalued their currencies in a bid to boost exports.

Despite the obvious hurdles, Hurtsellers told her audience she is bullish on the United States. While its recovery from the financial crisis has been weak relative to previous post-recession recoveries, she said, it is nonetheless on track compared to the earlier post-bust recoveries in countries where, as in this case, housing was at the core of the crisis.

Still, Hurtsellers warned, fixed income investors should be prepared for bond yields to remain low for some time. They also should expect shorter and more volatile business cycles, given that the Federal Reserve has relatively few stimulus tools left at its disposal.

However, she stressed that short- and long-term rates have been explicitly anchored by the Fed, which has eliminated one source of bond market volatility. Over the long run, she said, reduced volatility will be supportive of credit markets and help to contract the yield spread between Treasuries and riskier credit products.

Not everyone shares her optimism, of course. Hurtsellers observed that corporate credit markets are priced for a recession, even though U.S. corporations hold nearly $1.5 trillion in cash on their balance sheets and the collapse of the securitization market has reduced the supply of credit products.

"We have a lot of negative sentiment priced into the market," Hurtsellers said. "But as an asset manager, I'm trying to forge ahead by buying risk assets; something I started doing in September."

Hurtsellers advised fixed income managers to "buy what you believe in." While fundamental research would be important, she stressed that "great business models are out there (in the private sector). You can buy great credits and weather this storm." She advised buying high-quality spread assets with liquidity to help ride out the market's inevitable volatility.

Hurtsellers also recommended overweighting emerging-market sovereign debt. She said post-crisis policies in the United States are helping to keep the dollar under downward pressure, particularly against emerging-market currencies. And, she said, emerging-market economies are in some ways more fundamentally sound right now than their developed-market counterparts. SVA

The 2012 Elections: Time for a Change?

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Not surprisingly, Langer said, more than 70 percent of Americans saw the country as being on the wrong track. The last three times this occurred within a year of a presidential election, the incumbent president lost.

Despite those negatives, Langer noted, the president in mid-November still had a 44 percent job-approval rating. That's not a level that's typically associated with reelection, but it was nonetheless surprisingly high under the circumstances. The president even had a 35 percent approval rating on his handling of the economy, Langer said, which was better than former presidents Ronald Reagan, George H.W. Bush and George W. Bush scored at their lows: 22 percent, 33 percent, and 31 percent, respectively.

One reason for Obama's relatively strong approval ratings, Langer said, is that President Obama maintains a strong hold on his core supporters. In one recent poll, 80 percent of Democratic voters said they will stick with the president in 2012. By contrast, only 59 percent of Republican voters said they were satisfied with their party's candidates, although that wasn't terribly surprising during a primary battle in which party loyalties are divided among multiple candidates.

Langer did not hazard any guesses as to who would win the Republican nomination, but he did note that three of the four leading contenders at that time—Newt Gingrich, Herman Cain, and Rick Perry—all had higher unfavorable than favorable ratings outside of their own party.

By contrast, Langer noted, ratings for Obama and Romney were about evenly split between favorable and unfavorable when prospective voters were asked to rate them as potential head-to-head candidates in the 2012 presidential election.

Once the Republicans have picked a candidate, Langer said, the outcome of the 2012 presidential election will hinge on independent voters, who are a bigger part of the voting population than they have been in the past. "For the first time for a sustained period, and for far longer than we've seen in the past—for more than two years now—the number of people who identify themselves as independents outnumbers both Democrats and Republicans," Langer said. "That is a departure from the traditional political allegiances we've seen in the past."

Recognizing the new importance of independent voters, Langer said, will be essential to understanding the current election. "You are seeing to some extent a rejection of both political parties as we see the public struggling to find solutions to the problems we face," he said. "In a country that looks like this, anything is possible." SVA

Focusing on Stable Value Pooled Funds: Whither the 12-Month Put?

By Randy Myers

Would changing one of the most common features of pooled stable value funds help bring more wrap capacity to the stable value marketplace?

The feature in question is the 12-month notice that retirement plan sponsors must typically give to a pooled fund if they want to exit the fund and no longer offer it to their plan participants. The significance of the feature is rooted in the basic promise that stable value funds offer to participants, which is that, except under clearly defined and exceptional circumstances, they will always be able to execute transactions in their stable value fund, including withdrawals, at contract value. Contract value represents their accumulated interest plus principal.

Different types of stable value funds have different exit requirements. In the case of a segregated account stable value fund built for a specific sponsor, the fund is wound down over a period of time that matches the duration of its underlying investment portfolio. That can take two or three years.

Most pooled funds, by contrast, simply require that plan sponsors give 12 months notice before exiting a fund. This "12-month put" is designed to provide for an orderly withdrawal from the fund and to protect the fund's remaining plans, plan participants, and wrap issuers. All of them could be negatively impacted by an abrupt and unplanned liquidation of fund assets, especially when the fund's market-value-to-contract-value ratio is below 100 percent. That MV-to-CV ratio is always fluid, but when it is less than 100 percent, wrap issuers can be required to make up the difference between market and contract value for exiting plan participants. Fund managers, plan sponsors, and wrap issuers all seek to avoid invoking a wrap contract, though, since doing so can raise future costs for all parties.

In the wake of the recent credit crisis, some wrap issuers are no longer convinced that a 12-month put is adequate in an extreme, "run-on-the-market" scenario. Lengthening the term to as much as 18, 24, or even 36 months would minimize their risk, they argue, and perhaps bring more, much-needed capacity to their industry.

The follow-up question, of course, is this: Would plan sponsors be willing to accept such an extension?

Participants in a panel discussion at the 2011 SVIA Fall Forum couldn't reach a clear consensus on either question. Anthony Luna, a vice president and stable value portfolio manager for T. Rowe Price Associates, suggested that a 12-month put is probably adequate for prudently managed, well-diversified funds. He also argued that prudent fund management should be a bigger concern than plan exit terms.

By contrast, William McCloskey, a vice president in the Stable Value Markets Group at Prudential Retirement and head of its wrap and traditional GIC businesses, said that since longer put periods could mitigate some of the risk issuers face in pooled funds, it might allow them to underwrite more business.

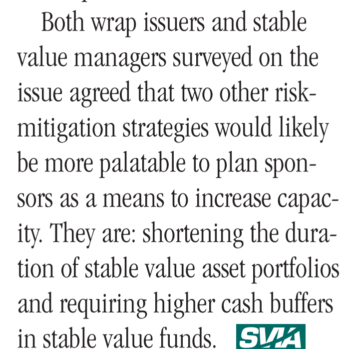
Such diverging opinions were reflected in a recent poll, the panelists observed, in which 10 of 12 wrap issuers said a 12-month put does not provide adequate protection against "run-on-the-bank" scenarios, while five of 17 stable value managers said it does. Similarly, 11 of the 12 issuers said longer put terms would bring more wrap capacity to the market, but only five of the 17 managers agreed.

Luna warned that if longer put terms weren't accompanied by fee reductions, better contract terms, or more wrap capacity, plan sponsors would almost certainly oppose them. "If this is just a pure give, it's just not going to work for plan fiduciaries," he said.

A plan sponsor in the audience commented that sponsors would likely view longer put terms as a negative. "Why would we want to go with something that has a higher put level?" the sponsor asked. "People already don't like the 12-month put. Try to explain to plan trustees that we can't get out of a fund because we have a 36-month put."

Bradie Barr, senior vice president, client management, for wrap issuer AEGON, pointed out that plan sponsors who use segregated rather than pooled stable value funds already have longer exit requirements.

Both wrap issuers and stable value managers surveyed on the issue agreed that two other risk-mitigation strategies would likely be more palatable to plan sponsors as a means to increase capacity. They are: shortening the duration of stable value asset portfolios and requiring higher cash buffers in stable value funds. SVIA



SVIA 2012 Fall Forum

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Generations: Key Drivers of Investment Behavior

By Randy Myers

Having witnessed two major bear markets in a single decade, some young investors appear to be steering clear of stocks. This could have an impact on their long-term financial security, as stocks historically have provided higher returns than other asset classes over long periods of time.

Addressing participants at the 2011 SVIA Fall Forum, Dean Hamilton, an investment analyst with mutual fund company, The Vanguard Group, said data compiled by the Investment Company Institute shows that among U.S. households headed by someone born between 1970 and 1979, less than 40 percent own stocks either directly or through mutual funds, exchange-traded funds, or variable annuities. By contrast, more than 52 percent of households in the 1960-to-1969 birth cohort own stocks directly or indirectly, as do nearly 55 percent of those in the 1950-to-1959 birth cohort. Even those born in the 1930s and 1940s are more likely to own stocks than those born in the 1970s, the data indicate.

ICI's research also found that among so-called "Generation Y" investors—those born between 1977 and 2001—only 25 percent identify themselves willing to take above-average risks for above-average gains. That compares with 33 percent of Generation Xers born between 1965 and 1976.

Intrigued by the ICI's findings, Hamilton said, Vanguard compared them with the behaviors of investors in the defined contribution plans for which Vanguard serves as recordkeeper. Among that group, it found, the average allocation to equities has actually risen for investors under the age of 30. The trend strengthened after enactment of the Pension Protection Act of 2006, which among other things allowed employers to enroll workers in defined contribution plans automatically. The Act also designated target-date funds as qualified default investment options in retirement savings plans, which likely boosted allocations to equities. Target-date funds seek to provide an asset allocation mix appropriate for an investor's age, and typically include a material allocation to stocks.

As target-date funds continue to grow in popularity, Hamilton suggested, allocations to equities by young investors should continue to grow. Vanguard's data indicate that where those funds are included in the investment lineup, allocations to equities by investors age 35 and younger are nearly 24 percentage points higher than in plans without those funds.

Vanguard's data suggest there is no "lost generation" of equity investors among the young, Hamilton concludes, at least in the retirement plan market. He attributed this finding to the growing popularity of auto-enrollment and target-date funds. To ensure brighter outcomes for retirement plan investors, though, he said plan sponsors may have to add still more features to their plans going forward, including auto-escalation of participant contributions and personalized investment advice for older plan participants who want to be more engaged in their retirement planning. SVIA

Risk Appetite Waning Among Generation Y Investors . . .

Generation Y Investors More Willing to Take "Average" Risk, Less Willing to Take "Above-Average" Risk
Percentage of U.S. Households Owning Mutual Funds by Head of Generation, 2010

Level of risk willing to take	**Generation Y** (born 1977-2001)	**Generation X** (born 1965-1976)	**Baby Boom Generation** (born 1946-1964)	**Silent and GI Generation** (born1904-1945)
Substantial risk for substantial gain	7%	7%	4%	2%
Above-average risk for above-average gain	25	33	26	14
Average risk for average gain	48	43	51	53
Below-average risk for below-average gain	11	11	11	16
Unwilling to take any risk	9	6	8	15

Sources: Investment Company Institute, 2011; *Profile of Mutual Fund Shareholders,* 2010.

Stable Value: Issuers' Perspectives

By Randy Myers

At the right price, it appears, some new players are prepared to step into the stable value wrap business after all.

In the wake of the 2008 credit crisis, when wrap issuers were earning only about seven basis points on the stable value portfolios they insured, some began leaving the business. The compensation, they argued, wasn't worth the risk. Wrap capacity has been an issue for the industry ever since; when Charles Schwab Bank announced late last year that it was going to shut down its $7.6 billion stable value fund, it cited wrap capacity constraints and the low-interest-rate environment as the reasons.

Wrap fees are now closer to 20 basis points. Those higher prices have enticed some new entrants into the market. In addition, some veteran issuers that had stopped writing new business after the crisis are finally looking to expand their footprint again by providing additional capacity.

RGA Reinsurance Company is one of the market's new entrants. RGA actuary Ryan Stevens told participants at the 2011 SVIA Fall Forum that his group has secured all the necessary internal approvals to enter the wrap business with a "sizeable capacity limit." It has begun filing contracts in key states, he said, and is in negotiations with several stable value managers to provide wrap capacity for some of the plans they serve.

"We expect the business to grow with the aging population and the increasing need for stable value products," Stevens said. "We find the current risk factors acceptable, given proper controls. It's a risk similar to those we analyze in our primary business (reinsuring mortality risk), and it fits well with our core competencies."

Stevens said RGA was working hard to have its first contract written by the end of 2011. If that didn't happen, it expected to have it done by early 2012. "From there, we're hoping to continue to build infrastructure and staff to grow the business in a measured way," he said. "We want to be a long-term player."

Among the veteran issuers ready to expand their footprint is New York Life Insurance, which in the past has limited its participation in the stable value marketplace to guaranteed investment contracts, or GICs. But David Cruz, a director in the company's Stable Value Investment Group, said that over the past year and a half, his group has gotten a commitment from the company to move into the wrap business. "It is probably going to be a measured step into the business," he stressed. "We're already familiar with a lot of plans (through our GIC business), and those are the ones with whom we are expanding our relationship."

Adam Silver, director of the 401(k) stable value group at Royal Bank of Canada, said his firm is also among the established wrap issuers who are prepared to start growing their business again, "although how big and fast is to be determined."

Silver, Cruz, and Stevens were part of a four-person panel, along with Marijn Smit, president of AEGON Stable Value Solutions, that assessed the outlook for the stable value wrap market during the SVIA's 2011 Fall Forum. AEGON is the largest wrap provider in the marketplace, Smit noted, with contracts on about $60 billion of fund balances, all on the synthetic side of the business. Smit said that's been a "pretty consistent number" for the past several years and that AEGON is not planning to grow it at the moment.

The company is interested, however, in seeing wrap capacity expand industry-wide. AEGON has been actively encouraging new players to enter the market, Smit said, even going so far as to use some of its administrative capabilities to help new competitors

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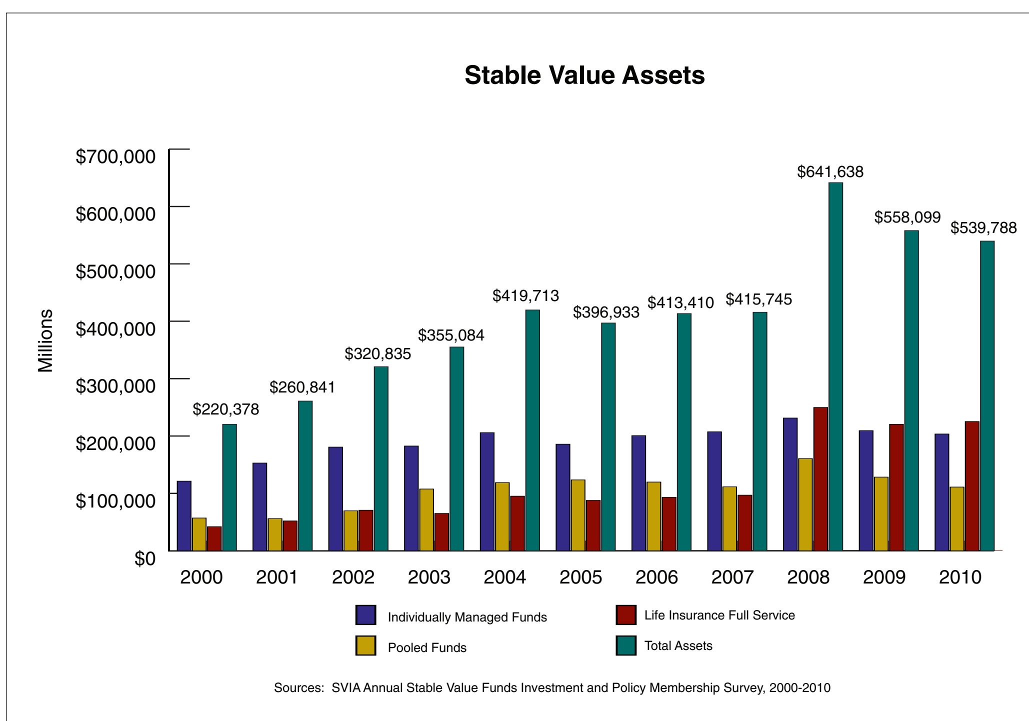
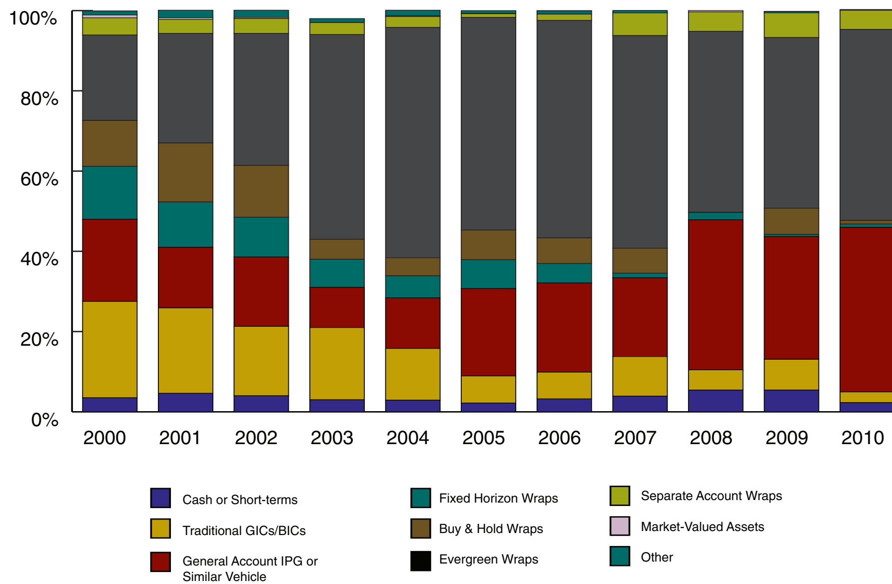


Sources: SVIA Annual Stable Value Funds Investment and Policy Membership Survey, 2000-2010



Stable Value: Issuers' Perspectives

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come up to speed. "It may seem counterintuitive," he said, "but we think it is in the overall best interests of the industry to have a diverse universe of providers."

Silver said the idea that wrap capacity constraints could prompt some stable value managers to follow Schwab's lead in exiting the business remains a legitimate concern, even though he continues to view stable value as an "incredibly attractive product for plan sponsors."

"Eventually, and hopefully sooner rather than later," Silver said, "other banks will come into the market."

Looking at other trends in the wrap market, the panel predicted that global wrap contracts, in which multiple wrap providers agree to similar terms when wrapping a single stable value fund, will likely continue to decline in importance. In 2006, the panel noted, 61 percent of stable value funds were globally wrapped; by 2010, that figure had fallen to 30 percent.

Cruz also noted that his organization is seeing more transparency from fund managers, a trend Silver applauded. "When we underwrite, we need to understand what the different strategies are, whether its in a global wrap structure or not," he said. "I think the new approach going forward is to have a lot more information about the overall asset structure of a fund and an understanding of who the other wrap providers are. One of the lessons we learned over the past few years is that all issuers take the credit risk of other issuers, and there is huge pressure to work problems out when an issuer gets into trouble to avoid harming the stable value fund."

Cruz also said his company now values the ability to periodically re-underwrite its exposure on its wrap contracts, which is why it is moving toward offering finite-maturity rather than evergreen wrap contracts. "Everybody understands maturity profiles and the ability to manage exposure to certain dates," he said. "I think that is an important consideration for us as we move forward."

Looking toward other possible changes in the stable value marketplace, some members of the panel expressed reservations about having stable value funds included in the portfolios of target-date retirement funds, or about seeing the stable value industry create "hybrid" or "income" funds that would feature both wrapped and

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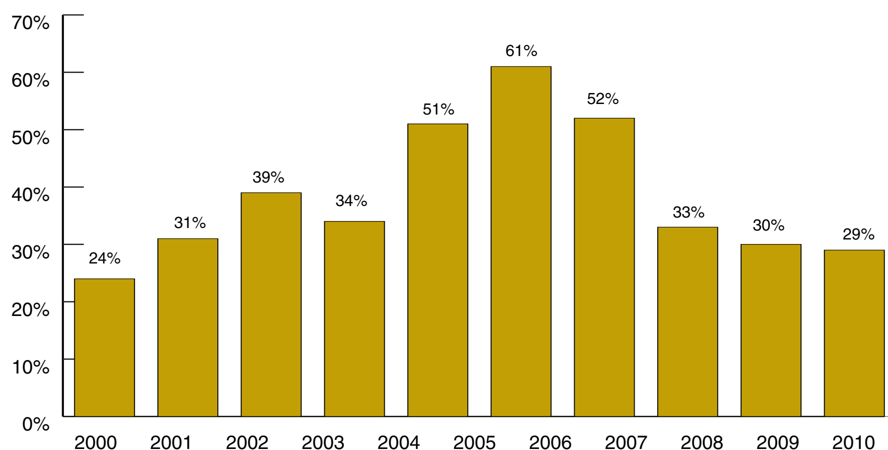

Income Funds: The Next Evolution for Stable Value?

By Randy Myers

Hybrid cars are the latest innovation in the automotive world, and some investment professionals are wondering if hybrid funds could be the next big thing in the stable value universe.

Only a handful of hybrid funds exist. There isn't even a consensus on what these funds should be called; some have also floated the term "income funds." Nevertheless, most agree on the general concept: a traditional stable value fund that also incorporates some investments not covered by a wrap contract. Allowing some assets to go unwrapped would both minimize the fund's costs—it wouldn't have to buy as much wrap capacity—and ease the burden of finding wrap providers at a time when wrap capacity is constrained.

Stable value funds traditionally have wrapped most of their underlying assets, of course, except where those assets are cash or money market funds. Wrap contracts assure stable value's benefit responsiveness, which enables investors to withdraw their assets at contract value under most circumstances, even if the market value of the fund's portfolio falls below contract value. This benefit responsiveness has been the foundation of stable value.

Interest in blending wrapped and unwrapped assets is largely an outgrowth of the 2008 credit crisis, which crimped capacity for the entire industry. Since then, many of the issuers who remained in the business have been pushing for more restrictive wrap contract provisions while raising fees. This has left some plan sponsors and managers frustrated.

"They see an industry that has not recovered from the financial crisis," Edward Adams, manager of defined contribution strategy and implementation for IBM Retirement Funds, told participants at the 2011 SVIA Fall Forum. "They see a wrap market where demand and supply are in imbalance, and that is a big concern for many of them. From their perspective, stable value has become an increased administrative burden."

IBM Retirement Funds oversees the largest 401(k) plan in the country for employees of International Business Machines Corporation (IBM). Adams said IBM still considers its stable value fund sufficiently attractive to justify any extra administrative burden. But not all plan sponsors feel the same way, and some have begun to look for alternatives.

"We are often asked about alternatives," Brett Gorman, a vice president in the defined contribution practice of fixed income manager Pacific Investment Management Company LLC (PIMCO), told forum participants. He said large and sophisticated plan sponsors understand the changes rippling through the stable value marketplace and to varying degrees are annoyed and frustrated by them. "More than a few are angry," he added, "having spent more time on stable value-related issues over the past three years than they have on running the rest of their plan."

Compounding their concerns, Gorman said, are new regulatory requirements taking effect in 2012 that will require sponsors to make additional fee disclosures about their plans to plan participants. "For many sponsors," he said, "stable value will be their most expensive investment option."

To be sure, hybrid or income funds would sacrifice one of the prized benefits that stable value funds offer: benefit responsiveness, which is the ability of participants to transact at contract value. Neither plan sponsors, stable value managers, nor wrap issuers know for sure how plan participants would react to the possibility of losing money in a hybrid fund. "It could work," Adams said, but he stressed that such a fund should not be called a stable value fund because it could cause too much confusion in the marketplace.

Gorman said that when a plan sponsor comes to his firm asking about alternatives to stable value funds, PIMCO first asks the sponsor whether it likes stable value funds and, if it answers in the affirmative, encourages the sponsor not to abandon it. PIMCO reminds the sponsor, he said, that no other investment has come close to delivering "the exceptional risk-return characteristics that stable value has delivered for decades."

PIMCO then helps the sponsor assess its stable value options by reviewing its wrap contracts. It looks to ensure that they don't push too much risk onto the sponsor's plan or its participants, and that the wrap issuers are easy to work with and committed to the stable value business. "Most sponsors," he said, "find they are in much better shape than they thought and can continue with a 100 percent traditional stable-value solution."

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Stable Value: Issuers' Perspectives

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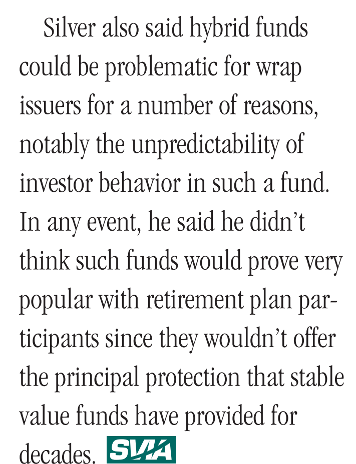
unwrapped assets. (See "Income Funds: The Next Evolution for Stable Value?" elsewhere in this issue of *Stable Times.*)

Silver said many investors were disappointed during the 2007-2009 stock market crash to find out that they could lose money in target-date funds, and that as a wrap provider he wasn't sure he wanted to be involved with "a product that doesn't ultimately achieve what it is expected to deliver."

Silver also said hybrid funds could be problematic for wrap issuers for a number of reasons, notably the unpredictability of investor behavior in such a fund. In any event, he said he didn't think such funds would prove very popular with retirement plan participants since they wouldn't offer the principal protection that stable value funds have provided for decades.



Evaluating Pooled Fund Risks under Extreme Conditions

By Randy Myers

Rising interest rates can be a challenge for stable value funds, and after years of falling rates, many in the stable value industry are wondering how they will react when rates finally do rise. Their attention is focused especially on pooled funds, since a single pooled fund can manage assets for hundreds of retirement plans.

The central concern is that the participants in those plans, in search of higher-returning investments, might pull money out of their stable value fund en masse. That would be an issue any time, as it would require the fund to liquidate assets quickly to meet redemption requests. It would be especially problematic in a rising-interest-rate environment, however, since the market value of the fund's underlying investment portfolio would likely be less than its contract value at that time.

In that situation, the issuers of the fund's wrap contracts could be forced to step in and cover the difference between contract and book value. That way, the fund could meet its promise of contract-value redemptions to plan participants. That would be good for the participants leaving the fund, but not so good for those remaining, as it would likely lead to higher fund costs in the future. Accordingly, all of the other parties involved—stable value managers, wrap-contract issuers, and plan sponsors—hope to avoid triggering wrap contract coverage unless it is absolutely necessary. Like other types of insurance, wrap contracts are something that stable value funds need but hope they never have to use.

For insight into how pooled funds might perform in a rising-rate environment, The Vanguard Group recently analyzed how its pooled stable value fund would react not just to a moderate increase in interest rates but to a sharp and sustained rise.

The company found that the fund would have fared quite well, Susan Graef, a principal at The Vanguard Group, told participants at the 2011 SVIA Fall Forum.

Graef runs the stable value team at Vanguard. She explained that her group began its analysis by looking at its own stable value fund at the end of February 2011, when it had a market-value-to-contract value (MV/CV) ratio of 103.5 percent. Its underlying portfolio of fixed income investments had an average duration of 2.6 years, and its crediting rate was 3.27 percent. For purposes of the stress test, Vanguard assumed that the fund's duration, convexity, and key rate duration distributions, as well as the option-adjusted spread on its underlying investments, would remain steady throughout the time period studied. The company further assumed that changes to the "yield to worst" of the fund's underlying investment portfolio would follow Treasury-curve rate changes.

To come up with a suitably rigorous stress test, Vanguard looked for a real-world example: the most severe period of interest rate tightening by the Federal Reserve since 1980. It found it in a two-and-a-half-year period from October 1986 to March 1989 during which yields on three-month U.S. Treasury bills shot up 382 basis points. Yields at the longer

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Income Funds: The Next Evolution for Stable Value?

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Nonetheless, Gorman said, hybrid or income funds could represent a reasonable compromise between the current needs of plan sponsors and the interests of wrap contract providers. Before that could happen, however, fund managers and wrap providers would have to figure out just how much of a fund's assets could be unwrapped and how they would be invested.

Aruna Hobbs, managing director and head of stable value investments for stable value provider New York Life Investments, said her team looked for answers by trying to model how a hypothetical hybrid fund might perform. Using the Barclays 1-3 Year Credit Index as a barometer for the unwrapped assets and the Barclays Intermediate-Aggregate Index for the wrapped assets, Hobbs' stable value team looked at how the fund might have performed during two periods of volatile interest rates: 1979-1982 and 2007-2011.

Assuming 10 percent of the fund's assets were unwrapped, Hobbs said, the fund's crediting rate never turned negative. Nor did the crediting rate vary much from the crediting rate for a pure stable value fund. With 50 percent of the fund unwrapped, however, the crediting rate became much more volatile, and at times was negative.

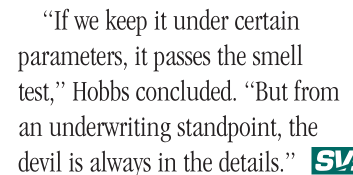
"Clearly we would not feel comfortable with 50 percent of the assets being unwrapped," she said. They also would be concerned to know, she said, at what point investors would start pulling money out of a hybrid fund en masse. While she wasn't sure when participants would start doing that, she speculated that it might be when returns become negative..

Leaving too much of a portfolio unwrapped could also diminish the "stable value" benefits of the fund so much that it might no longer be considered a safe investment option by investors, Hobbs noted. At that point, she speculated, "why not just have an unwrapped intermediate-term bond fund?"

Hobbs also wondered whether, in the absence of a pure principal-protected investment option such as a stable value fund, more retirement plans might consider adding money market funds to their investment menus.

Hobbs said New York Life Investments would look at proposed hybrid funds on a case-by-case basis before determining whether it would be willing to issue wrap contracts for that portion of the fund managed by conventional standards.

"If we keep it under certain parameters, it passes the smell test," Hobbs concluded. "But from an underwriting standpoint, the devil is always in the details."



Plan Sponsors, Service Providers Prep for New Fee Disclosure Rules

By Randy Myers

Barring any last-minute postponement by the U.S. Department of Labor (DOL), retirement plans and their service providers will face a new set of compensation disclosure requirements beginning April 1, 2012.

The new requirements are spelled out under Section 408(b)(2) of the Employee Retirement Income Security Act, or ERISA. They specify that "covered service providers" must disclose compensation information to their defined-contribution-plan and defined-benefit-plan clients.

Covered service providers include any person or entity acting as an ERISA fiduciary or registered investment advisor, or providing recordkeeping or brokerage services to a participant-directed plan. They also include anyone that provides certain other services in expectation of receiving indirect compensation; these services include brokerage and consulting services, third-party administration, or investment advice. Providers of stable value wrap contracts are not covered service providers, attorney Donald Myers, a partner in the Employee Benefits and Executive Compensation group at Morgan, Lewis, Bockus LLP, told participants at the 2011 SVIA Fall Forum.

Myers said he didn't expect DOL to impose any further delays in implementing the new rules, which originally had been slated to take effect in July 2011.

Accordingly, Myers recommended that plan fiduciaries begin determining which of their service providers are covered service providers and then confirm that those vendors are prepared to make the requisite disclosures on a timely basis. Fiduciaries also should start developing a process for requesting missing information from those service providers, and for notifying DOL if information is not received on a timely basis. Finally, he said, they should start developing a process for reviewing the information they receive to determine if a service provider's compensation is reasonable.

In addition to the new 408(b)(2) reporting requirements, Myers noted that DOL also has released final regulations under ERISA Section 404(a) requiring

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Evaluating Pooled Fund Risks under Extreme Conditions

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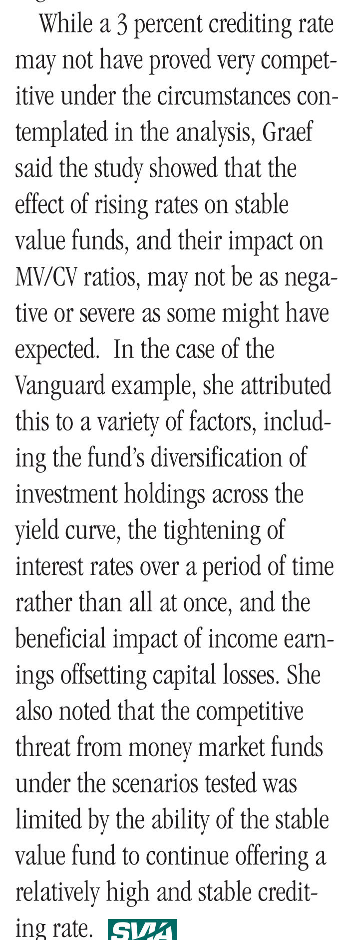
end of the yield curve rose substantially as well.

Next, Vanguard looked at how its fund would have fared, beginning in February 2011, if rates moved that dramatically again. Itmodeled three different scenarios. Under the first, or base-case, scenario, it simply layered on the same interest rate changes that took place in the 1986-1989 period. Under the second scenario, it assumed the same interest rate changes but also calculated that for every month in which yields on money market funds were within 50 basis points or less of stable value funds, some plan sponsors would leave the fund, withdrawing 5 percent of its assets. Under the third scenario, it again assumed the same interest rate scenario but calculated that for every month where the fund's MV/CV ratio fell below 98 percent, some plan sponsors would leave the fund, this time withdrawing 10 percent of the fund's assets each time.

Stable value funds have not experienced withdrawal rates on that magnitude, Graef noted, but she said Vanguard wanted to create a severe stress test. To further exaggerate the negatives, the test assumed that although plan sponsors normally must wait 12 months before they are entitled to contract-value withdrawals in rising rate environments, they would be allowed to make them just one month after the triggering events built into the stress test.

Under the base case, the fund's MV/CV ratio fell to 97.4 percent from 103.5 percent during the period when the Fed was tightening, then recovered to 100.1 percent within 12 months after the tightening ended. While price returns on the fund's underlying portfolio turned negative, cumulative interest earnings produced a positive total return for the period.

Under the second scenario, 25 percent of the fund's assets were withdrawn around the peak of the Fed's tightening period. The fund's crediting rate declined but held above the three percent level. The MV/CV ratio hit a low of 97 percent, recovering to just over par three months later. Again, the cumulative total return for the period was positive.



Under the third scenario, the calculated crediting rate again stayed above 3 percent, and the cumulative total return for the fund's portfolio again was positive. However, total assets in the fund fell by 55 percent during the tested period, the bulk of that during one six-month stretch.

While a 3 percent crediting rate may not have proved very competitive under the circumstances contemplated in the analysis, Graef said the study showed that the effect of rising rates on stable value funds, and their impact on MV/CV ratios, may not be as negative or severe as some might have expected. In the case of the Vanguard example, she attributed this to a variety of factors, including the fund's diversification of investment holdings across the yield curve, the tightening of interest rates over a period of time rather than all at once, and the beneficial impact of income earnings offsetting capital losses. She also noted that the competitive threat from money market funds under the scenarios tested was limited by the ability of the stable value fund to continue offering a relatively high and stable crediting rate. SVIA

Editor's Corner

By Marijn Smit, AEGON Stable Value Solutions

In pulling together this last issue of *Stable Times* in 2011, I was struck by both the breadth and the depth of the articles. The articles, which highlight SVIA's Fall Forum and Annual Meeting that was held on November 16-18, addressed many of the challenges that the stable value industry has faced in the wake of the financial crisis.

Stable value was one of the few asset classes that delivered positive returns during the height of the crisis, and it continues to provide capital preservation plus consistent, positive returns in the current low-interest-rate environment. And in this environment, stable value continues to offer a considerable premium over money market funds. No other 401(k) asset offers the unique combination of benefits that stable value has consistently provided, which will ensure it remains a core component in 401(k) participants' asset allocation.

While the benefits of stable value to plan participants cannot be emphasized enough, stable value's value proposition is under increased scrutiny by plan sponsors and their consultants. Simply put: Are the diversification benefits, principal preservation, conservative nature, and steady 100- to 200-basis-point premium over money markets that stable value provides worth the additional work and attention that stable value funds require? This additional work is examined in more detail in this issue of *Stable Times* in discussions about capacity, the 12-month-put for pooled funds, looking at pooled fund performance in extreme market conditions, and new fee levels for wrap contracts.

This examination of stable value is fundamentally good in two ways. It helps us build a better, more sustainable product that meets the evolving needs of plan participants and plan sponsors. And it builds a better understanding of stable value among all stakeholders: plan sponsors, consultants, plan participants, stable value managers, and stable value providers, which the financial crisis pointed out was sometimes surprisingly lacking for an asset class that has over 35 years of solid performance.

While alternatives to stable value are explored and at times even adopted, this has to come with the recognition that none deliver stable value's unique combination of benefits. The industry has an opportunity to make stable value even more sustainable and available as we tackle the challenges ahead.

With financial pundits offering all sorts of advice on the markets and 401(k) asset allocation, I would advise that stable value is the one asset class that has offered both stability and consistency throughout all the turmoil in financial markets. For those who are wondering whether the additional work is worth it, I would offer that this seems a relatively small price to pay for the benefits that participants reap. And, as this issue will prove, stable value market participants are facing stable value challenges head on.

I hope you enjoy this issue of *Stable Times* as we mark up 2011 as another year in which the stable value industry has added to its successful track record.

Plan Sponsors, Service Providers Prep for New Fee Disclosure Rules

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participant-directed individual retirement plans, such as 401(k) plans, to make certain new disclosures to their participants and beneficiaries.

In addition to generating information about investments and administrative expenses, plans must provide performance and expense data for each of their investment options. Also, plan administrators must make sure a website is available where plan participants can review this information, along with a glossary of investment and financial terms or a link to such a glossary.

The SVIA recently surveyed 22 stable value managers to find out how they're reporting fees now and how they are interpreting the new regulations with respect to stable value funds. In particular, the survey wanted to find out how they plan to account for stable value wrap fees. Eight of the surveyed managers were insurance companies.

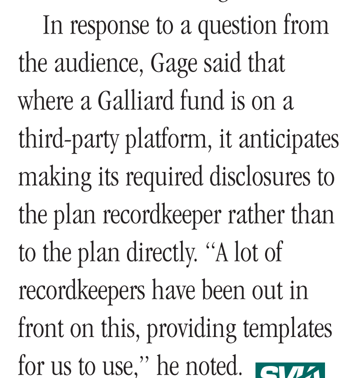
The majority of the insurance companies said they currently report wrap fees in their expense ratios, while the majority of the other managers do not. About half the surveyed managers said they expect their reported expense ratios to change once the new regulations go into effect. A majority said they view wrap fees as an administrative fee for reporting purposes, rather than as a trading fee or "other" fee. "In our view," observed Nick Gage, associate director at Galliard Capital Management and a speaker at the SVIA Fall Forum, "that would argue for including them in the overall expense ratio."

Half the managers surveyed said clients were indifferent as to how wrap fees were reported. Clients wanted to know that their stable value managers were prepared to comply with the reporting requirements. Only five managers said clients had indicated they wanted the wrap fees to be included in the expense ratio.

Some large financial institutions, Myers noted, have taken the position that wrap fees aren't part of the expense ratio and should be disclosed separately. "There really isn't any specific guidance from DOL about how to do it; maybe the final regulations will deal with it," he said. "Right now, I don't think there's necessarily a right or wrong way."

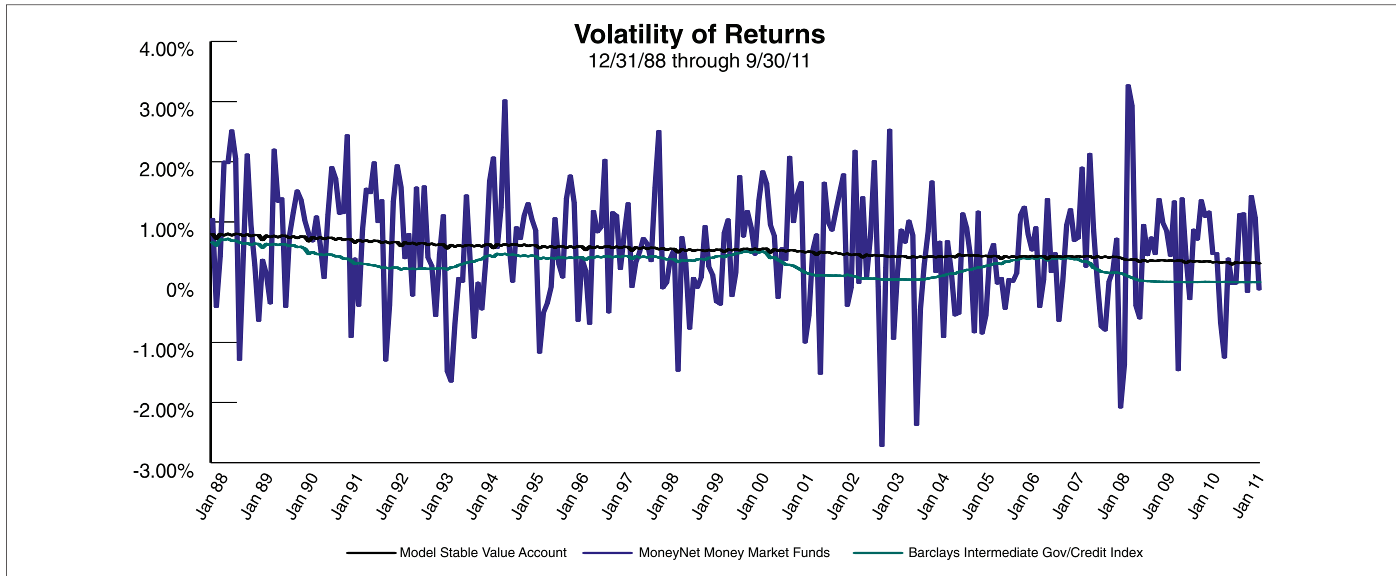
Galliard's anticipated approach, Gage said, will be to report wrap fees as a line item within fund operating expenses and in the headline expense ratio reported to participants. He suggested that would best meet the expectations of clients and their consultants and satisfy both the spirit and letter of the new DOL regulations.

In response to a question from the audience, Gage said that where a Galliard fund is on a third-party platform, it anticipates making its required disclosures to the plan recordkeeper rather than to the plan directly. "A lot of recordkeepers have been out in front on this, providing templates for us to use," he noted.



Stable Value Funds Deliver for Investors in 2011

By Randy Myers



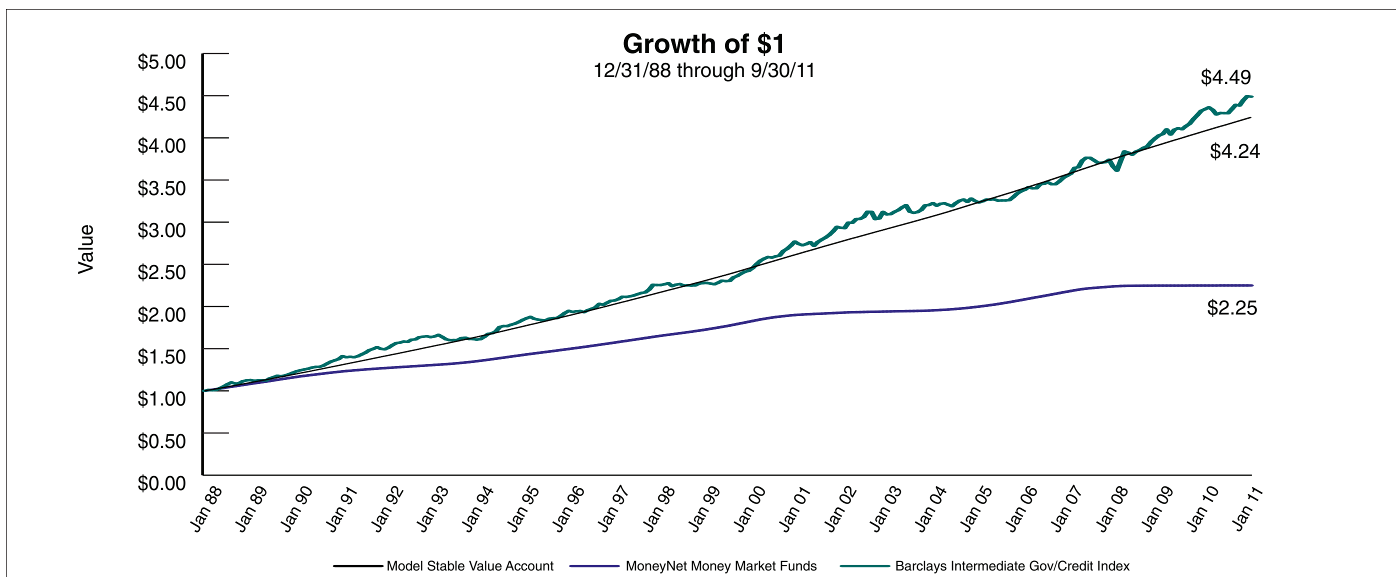
Investors want two things from their stable value funds: capital preservation and a steady, predictable return on their investment. In 2011, stable value funds continued to deliver those benefits, SVIA president Gina Mitchell told participants at the organization's Fall Forum, held in November in Washington, D.C.

Acknowledging that stable value investors value the journey as much as the destination, Mitchell noted that stable value funds in 2011 continued to deliver returns in line with those available from intermediate-term bond funds, but with less volatility.

From the end of 1988 through the third quarter of 2011, Mitchell noted that a model stable value account would have generated an average annual return of 4.24 percent, nearly in line with the 4.49 percent average annual return of the Barclays Intermediate Government/Credit Bond Index. By contrast, money market funds over that period of time generated average annual returns of only about 2.25 percent.

Meanwhile, interest rates have declined dramatically since the credit crisis began. The yield on the two-year Treasury note, for example, has fallen from just over 5 percent to about 0.25 percent, yet crediting rates on stable value funds have eased much more gradually. Stable value funds surveyed at the end of September were offering an average crediting rate of 2.99 percent, Mitchell noted, down from 4.81 percent in 2007.

Stable value funds can smooth out interest-rate volatility thanks to their investment contracts, which provide participants contract value withdrawal rights under most circumstances. The contracts allow funds to amortize their gains and losses over the duration of the portfolio, smoothing out returns to investors. SVIA



Dodd-Frank: Implementing the Law through Regulations

By Randy Myers

When Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010, says Scott Talbott, it wrote a check regulators cannot cash, at least in the time frame Congress allotted.

Dodd-Frank has been called the most sweeping reform of financial regulation in the United States since the Great Depression. To date, regulators have succeeded in completing only about 5 percent of the regulations and studies required by the new law, Talbott told participants at the 2011 SVIA Fall Forum. That doesn't count work on the so-called Volcker rule, a part of Dodd-Frank still being developed to prohibit U.S. banks from engaging in proprietary trading.

Talbott, senior vice president for government affairs at the Financial Services Roundtable, a trade organization, said the Dodd-Frank regulations that have been completed represent only about 3 percent to 4 percent of the impact the law will eventually have on the financial markets and its participants. Fully implemented, he said, the law will decrease GDP by about 3 percent, increase borrowing costs 25 to 50 basis points, and cost the economy jobs.

"The total cost of compliance so far, just for the rules that have been rolled out, is about 3 billion man-hours," Talbott said. "That's equivalent to about 15,000 employees working full-time on compliance. And that is before we even get to the rest of the regulations. So the worst is yet to come."

Talbott noted that regulators still haven't produced anything definitive on the regulation of over-the-counter derivatives contracts, for example. That portion of the law, along with the Volcker rule, is expected to account for about 50 percent of the impact on the financial markets.

One reason regulators have missed 70 percent of the deadlines imposed by Dodd-Frank, Talbott said, is because they're understaffed. While Republicans have chosen to withhold funding in an effort to slow them down, he said his organization would prefer the regulators get the money they need so that they can craft good rules. "We'd rather have regulators take the time and do it right," he said, "than issue a bad rule and have it overturned."

Before taking questions from the audience, Talbott ran down the status of several of Dodd-Frank's major components:

Living wills. Dodd-Frank requires that financial institutions write plans for their own demise should their fortunes take a turn for the worse. While regulations have been issued, they have yet to be implemented. Talbott characterized the living-will requirement as a "big deal" for the nation's smaller financial institutions but "more of an annoyance" for the larger ones. Fortunately, he said, "it has a long phase-in period we can work with." The biggest concern many financial institutions have, he said, revolves around the possibility for their proprietary information to become public.

The Volcker rule. "This is a behemoth," Talbott said. "No other proposal raises more questions than it answers than this one." Regulators, he noted, came out with a proposed rule that posed 200 questions to the industry, each with three or four additional sub-questions. "It's a mess," he said. "We can't even figure it out. The cost of compliance is going to go through the roof."

Non-bank systemically important financial institutions. Dodd-Frank requires additional regulatory oversight and tougher capital and liquidity requirements for "systemically important" financial institutions. Regulators, Talbott said, are still trying to figure out exactly what qualifies as a "SIFI," and a preliminary outline they've issued does not provide a lot of clarity.

Derivatives. Dodd-Frank requires that over-the-counter derivatives transactions be run through a clearinghouse or an exchange, but regulators haven't determined for sure yet what qualifies as a derivative. The law does provide for an end-user carve-out from compliance, but since the counterparty to most end-users will be a financial institution, there's concern about how much relief a carve-out might offer. "We have a couple little proposals, but there are major pieces of this regulation yet to be rolled out," Talbott cautioned.

Interchange fees. The banking industry lost to merchants, Talbott said, when Dodd-Frank specified that banks should have limits on what they can charge merchants via interchange fees on debit-card transactions. Interchange fees are charged between banks for the accepting card-based transactions, and they are deducted from what the merchant receives for a sale. Before Dodd-Frank, Talbott said, interchange fees averaged 44 cents per transaction, and now they are half that.

Consumer Financial Protection Bureau. Dodd-Frank created the CFPB to protect consumers of mortgages, credit cards, and other financial products and services. Opposed by many Republicans, it remains something of a toothless agency, as Congress blocked efforts by President Obama to appoint director until the December Congressional holiday recess. "You can't issue rules without a director, so it's just sitting there, doing a lot of studies and focus groups and filling out disclosure forms," Talbott said. He noted that the financial services industry is skeptical of the CFPB. "The goal is to let a consumer walk into any financial institution and compare terms between bank A, B, and C, so that they can make an informed decision," he explained. "At first blush, that sounds good. What we're worried about is that this push toward comparability

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ERISA's Increasing Importance

By Randy Myers

The stock market crash of 2007-2009 threw into stark relief the shortcomings of the U.S. retirement system. Millions of Americans are responsible for their own retirement security via 401(k) plans, and as the Dow Jones Industrial Average fell nearly 50 percent, many of them saw their retirement dreams jeopardized.

Now, with more than 76 million Baby Boomers at or nearing retirement age, the U.S. Department of Labor (DOL) is seeking to strengthen that retirement system—a responsibility it shoulders under the Employee Retirement Income Security Act of 1974 (ERISA).

Veteran investment banker Michael Davis was thrown into the effort in May 2009 when he was sworn in as deputy assistant secretary for DOL's Employee Benefits Security Administration (EBSA). It was about that time, he told participants at the 2011 SVIA Fall Forum, that EBSA was tasked with reviewing the appropriateness of target-date mutual funds for retirement savers.

Some members of Congress became concerned that target-date funds, especially those with a target date of 2010, were too heavily invested in stocks. Many had suffered severe losses during the 2007-2009 stock market crash. Some critics pushed DOL to specify just how much of a target-date fund's portfolio could be allocated to equities.

DOL demurred on that point, Davis said, deeming it an inappropriate path for regulators. EBSA did, however, do three other things after concluding that there was a disconnect between what fund providers thought they were offering investors in target-date funds and what investors thought they were getting. First, it issued guidance to retirement plan participants on what to look for when investing in target-date funds. It also started to develop guidance for retirement plan fiduciaries to choose and monitor target-date funds for their plans; that work is nearly complete. Finally, it proposed regulations that would require plan administrators to disclose more information to plan participants about the target-date funds offered in their plans.

Apart from its work on target-date funds, EBSA also has been developing the regulations needed to implement the new section 408(b)(2) of ERISA requiring greater fee transparency by defined contribution retirement plans. Beginning in April 2012, assuming no delays are announced before then, service providers will be required to disclose more information about their retirement fees. Shortly thereafter, under Section 404(a) of ERISA, plans will be required to share more fee information with plan participants.

"We have finished our work and the regulations have been cleared by the Office of Management and Budget," Davis said, indicating that the regulations could be issued "any day." (See "Plan Sponsors, Service Providers Prep for New Fee Disclosure Rules" in this edition of *Stable Times.*)

In the meantime, EBSA is continuing activity on several other fronts, too. One of its major initiatives, Davis said, is to look at what can be done to help retirees secure lifetime income in retirement. With the Baby Boomer generation starting to retire, many people will soon be shifting from trying to accumulate assets to figuring out how to spend them responsibly. "What advice should be given, what products are out there?" Davis asked. "That conversation is just beginning."

Davis said EBSA is looking into whether retirement plans should be required to report account balances not just as a lump sum but also in the form of a monthly income equivalent. However, he said, it is not in favor of requiring retirement plan participants to annuitize their retirement plan savings.

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Dodd-Frank: Implementing the Law through Regulations

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will lead to a homogenization of products. If banks only compete on one or two terms, all products will tend toward one or two things—although regulators say that's not what they want."

Mortgages. Dodd-Frank made a number of changes designed to tighten mortgage underwriting standards and also specified that financial services firms that securitize mortgages retain 5 percent of the associated risk. While that's a sound idea, Talbott said, financial services firms aren't happy with how the proposed risk retention levels would be implemented. When the industry balked, for example, at the idea of having to retain 5 percent of the risk on very sound mortgages, regulators proposed to drop the requirement for mortgages featuring a 20 percent down-payment by the borrower. The mortgage industry is pushing for a 10 percent cutoff.

Regulators also have proposed that when securitizing mortgages, lenders establish a "premium capture reserve account" where they would hold anticipated profits in a first-loss position against any losses that security generates. The industry argues this would make securitization so unprofitable that lenders just won't do it, reducing the amount of money available to consumers for mortgages. "So far, the regulators have been somewhat willing to listen," he said.

Talbott cautioned that contrary to the hopes of some in the financial services industry, Dodd-Frank is not going to be repealed. It is popular politically, he said, and will be a big part of President Obama's campaign platform. "We will be able to fine-tune it and make tweaks," he said, "but even that's not going to happen until 2013 or 2014." SVIA

Dodd-Frank: An Update on Stable Value Contracts

By Randy Myers

Approximately a year and a half after passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, federal regulators have yet to hand down final rules on how the swaps market will be regulated.

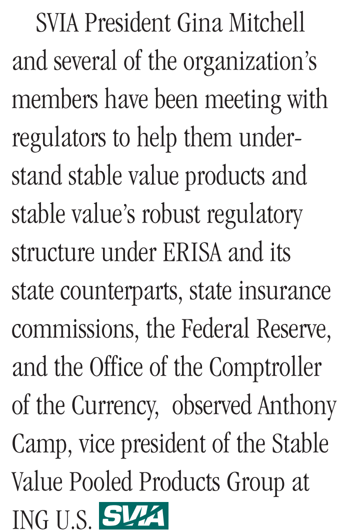
Dodd-Frank specifies that swaps—a term used broadly to cover just about any type of over-the-counter derivatives contract—must be cleared on an exchange or by a clearinghouse. The Securities & Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) are responsible for writing the necessary regulations.

In a presentation to participants at the 2011 SVIA Fall Forum, Anthony Mansfield, a partner with the law firm of Cadwalader, Wickersham & Taft, noted that Dodd-Frank called for a joint SEC-CFTC study group to determine whether stable value contracts meet the definition of a swap. Under the legislation's language, Cadwalader explained, the contracts would not be treated as swaps unless the study group concludes that they should be and the SEC and CFTC commissioners then agree. As the study group hasn't yet completed its work, that means that stable value contracts are not, at least for the moment, swaps.

Mansfield said the SEC has indicated that it will not finalize the results of the study group until regulators issue their final definition of a swap, which also is incomplete.

"There will be a push to get this done, but there won't be a sense of urgency," Mansfield said, noting that other aspects of Dodd-Frank are taking priority on the regulatory agenda. Once the study group does issue a recommendation on stable value contracts, he said, it also now appears that regulators will seek public comment before making a final decision on the matter.

Stephen Kolocotronis, vice president and associate general counsel of Fidelity Investments, added that regulators have indicated they may rule that stable value contracts are swaps but then exempt them from Dodd-Frank under authority provided in the law specifically for these contracts. Regulators are concerned, he said, that if they simply rule that stable value contracts are not swaps, other financial services firms may try to make the same argument for other products, ultimately circumventing the will of Congress.



SVIA President Gina Mitchell and several of the organization's members have been meeting with regulators to help them understand stable value products and stable value's robust regulatory structure under ERISA and its state counterparts, state insurance commissions, the Federal Reserve, and the Office of the Comptroller of the Currency, observed Anthony Camp, vice president of the Stable Value Pooled Products Group at ING U.S. SVIA

ERISA's Increasing Importance

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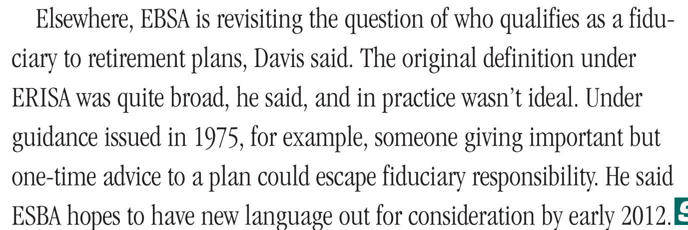

Elsewhere, EBSA is revisiting the question of who qualifies as a fiduciary to retirement plans, Davis said. The original definition under ERISA was quite broad, he said, and in practice wasn't ideal. Under guidance issued in 1975, for example, someone giving important but one-time advice to a plan could escape fiduciary responsibility. He said ESBA hopes to have new language out for consideration by early 2012. SVIA

SVIA Elects New Board Members

SVIA members elected four new members to the Board of Directors. Ninety-four percent of the membership voted in the election. UTC's Joe Fazzino was affirmed by the membership as a plan sponsor member of the Board. His three-year term begins on January 1, 2012.

The following service firm members were elected to serve a three-year term beginning on January 1, 2012:

- Brett Gorman, PIMCO,
- Susan Graef, The Vanguard Group,
- Steve LeLaurin, INVESCO, and
- Timothy Stumpff, Morley Financial Services.

The election this year was a very tough and tight one because there was a broad and excellent slate of candidates.

SVIA thanks TRowePrice's Tony Luna, ING's Steve Schaefer, and Jackson National's Terry Finan for running for the Board.

Stable Value Viewed with Increasing Favor by Plan Sponsors and Consultants

By Randy Myers

In the aftermath of the credit crisis, stable value funds are looking more attractive to many retirement plan sponsors and their consultants.

In the spring of 2011, The Vanguard Group surveyed sponsors of defined contribution plans and consultants who advise them. The primary goal was to gauge how much attitudes have changed over the past three years about target-date funds, one of the newer investment options in retirement savings plans. However, Vanguard also asked survey respondents about their changing views of other investments, including stable value funds. Respondents were asked to score

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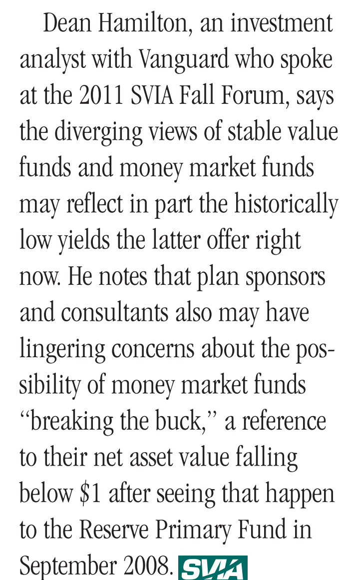
each investment option on a scale of one to five, with five representing the most favorable attitude change and one representing the least favorable change.

Among sponsors who offer target-date funds in their plans, 28 percent said their attitude toward stable value funds has become more favorable over the past three years, with 21 percent giving the asset class a score of four and 7 percent the highest possible score of five. A majority of these respondents—53 percent—gave a neutral response, while just 15 percent gave stable value a rating of two. Just 4 percent assigned it a rating of one.

Results among sponsors who do not offer target-date funds were similar, while results among retirement plan consultants were even better. Among that group, 56 percent said their attitude toward stable value had become more favorable over the past three years. A healthy 19 percent gave stable value a top rating of five, and 37 percent rated it four. Only 2 percent of consultants gave stable value a rating of one.

Vanguard found that perceptions of money market funds fared the worst of all asset classes over the last three years. Among sponsors offering target-date funds, for example, 11 percent gave it the worst rating of one, and another 32 percent gave it a rating of just two.



Dean Hamilton, an investment analyst with Vanguard who spoke at the 2011 SVIA Fall Forum, says the diverging views of stable value funds and money market funds may reflect in part the historically low yields the latter offer right now. He notes that plan sponsors and consultants also may have lingering concerns about the possibility of money market funds "breaking the buck," a reference to their net asset value falling below $1 after seeing that happen to the Reserve Primary Fund in September 2008. SVIA

SVIA Stable Value Funds' Quarterly Characteristics

Fourth Quarter 2008 through Third Quarter 2011

Stable Value Fund Statistics	Dec 2008	Mar 2009	Jun 2009	Sep 2009	Dec 2009	Mar 2010	Jun 2010	Sep 2010	Dec 2010	Mar 2011	Jun 2011	Sep 2011
Total Assets ($ millions)	$345,844	$358,490	$355,615	$387,743	$423,470	$438,854	$436,839	$437,315	$443,613	$434,613	$404,869	$435,256
Crediting Rates	4.05%	3.38%	3.15%	3.52%	3.35%	3.24%	3.25%	3.22%	3.26%	3.04%	3.01%	2.99%
Duration	2.75	2.62	2.81	2.83	2.89	2.88	2.8	2.84	3	2.82	2.84	2.76
Credit Quality	8.96	8.87	8.82	8.87	8.74	8.64	8.51	8.51	8.47	8.67	8.69	8.23
Market to Book Ration	95.05%	95.55%	97.17%	100.55%	101.00%	101.53%	102.94%	103.97%	102.84%	102.70%	103.72%	104.15%

Source: SVIA Stable Value Fund Quarterly Characteristics Survey from Fourth Quarter 2008 - Third Quarter 2011.
The survey covers 25 stable value managers who are SVIA members.
Credit Quality is based on Standard and Poor Ratings, with AAA=10, AA+=9, AA=8, etc.