

SVIA STABLE TIMES

VOLUME 2 • ISSUE 5

FOURTH QUARTER 1998

INSIDE THE NATIONAL RETIREMENT DEBATE *An Outlook for Stable Value*

Duncan Osborne, SVIA Freelance Writer

The Role of Alternative Products & Markets

The Stable Value Investment Association's National Forum on Capital Ideas: Inside the Retirement Debate opened with a symposium on October 27 on alternative products and markets. Much of the symposium's discussion focused on keeping stable value attractive to investors and growing market share.

Using Equities in Stable Value

The symposium's first debate was the role of equities in stable value. "Equities are slowly making their way into stable value portfolios," says C. Jason Psome, a Principal at Bankers Trust.

Robert W. Whiteford, a Vice President in Bank of America's Financial Engineering and Risk Management Group, supported adding equities to a stable value portfolio. "If you are looking at it for the long haul having a mix of equities and fixed income, I think that would be a good thing" Whiteford declares. He is also weighing adding commodities in a stable value portfolio.

"Well of course it can be dangerous, just as actively managed fixed income funds can be dangerous if they aren't properly managed. It is also another way to diversify your investment options and reduce the volatility of the funds managed," explains Whiteford.

While the products are exciting, a conservative industry may frown on using these new asset classes. Education efforts have trained participants to expect fixed income products and GICs to be the dominant, if not exclusively the assets that comprise a stable value portfolio. Including new, and riskier, assets requires new educational efforts.

"This is one component of stable value which is, unfortunately, not necessarily scientifically related," Psome emphasizes. "How the stable value option is communicated to participants will determine what you put in because it is also a public relations issue."

However, the industry may not yet be quite ready to add equity assets to stable value portfolios. Based on a poll of symposium participants, almost all of the 125 participants supported traditional asset classes in stable value, bonds and GICs. Only three participants supported

"DEBATE" continued on page 9.

IN THIS ISSUE OF SVIA

INSIDE THE NATIONAL RETIREMENT DEBATE	1
<i>The Role of Alternative Products & Markets</i>	1
<i>Using Equities in Stable Value</i>	1
<i>Stable Value Enters Mutual Fund & IRA Markets</i>	9
<i>Global Outlook for Stable Value</i>	9
<i>Looking North to Canada</i>	10
<i>Looking to the Old Country, Europe</i>	10
<i>Media Challenge: Getting Coverage in a Bull Market</i>	12
<i>U.S. Social Security Participants: Another Market?</i>	12
<i>Role of Pension Reform Unclear in Social Security Debate</i>	14
<i>Market Outlook: More Volatility in Equities & Low-Interest Rates</i>	14
<i>A Look at the Life Insurance Industry</i>	14
<i>SVIA Honors Murray Becker</i>	14
<i>SVIA Effort on Proposed Class Exemption For Synthetic GICs Explained</i>	15
FROM THE EDITOR	2
FROM THE PRESIDENT	2
BACK TO BASICS: WHAT DO WE WANT A STABLE PERFORMANCE MEASURE TO DO?	3
STABLE VALUE RISK MANAGEMENT: A CHECKLIST	4
TRENDS IN STABLE VALUE SYSTEMS AND OPERATIONS: ELECTRONIC FUND STATEMENTS	6
HOW IBM AND ITS EMPLOYEES USE STABLE VALUE	7
NEWS FROM SVIA	8
• <i>SVIA's 98 Media Highlights on CDROM</i>	
• <i>Save October 12-14, 1999 for SVIA National Forum</i>	
• <i>SVIA responds to inquiries on stable value</i>	
• <i>1998-1999 Membership Directory</i>	
J.P. MORGAN TO HOST RETIREMENT RECEPTION FOR MURRY BECKER	13
STABLE TIMES	16
CROSSWORD PUZZLE	

FROM THE EDITOR

An Appetite for Sound Bites*Allan Fen, Fidelity Investments*

As I was watching the election returns, it struck me how quickly things come into and go out of fashion. It's as true with investment fads as it is with political fortunes, as our dear departed Speaker can attest. With Bimbrogio in its final death throes, a new media obsession has suddenly emerged. Yes, it's stable value and it's hot, hot, hot. After years of being ignored or dismissed by the experts as irrelevant, this is a dramatic turn of events. You can hardly pick up a newspaper or turn on the television without seeing high praise lavished on a balanced investment strategy, with stable value often being mentioned in the context of DC plans.

Needless to say, this new-found respectability is a welcome change and it isn't just a media creation. Anecdotal evidence abounds indicating that cash flow into stable value options has increased as defined contribution investors have also rediscovered the benefits of stable value. And I have certainly noticed that plan sponsors are taking more of an interest in their stable value funds. Some plans that no longer have a stable value option are even adding them back. It's enough to make one hearken back to the glory days, when stable value was the most popular option and no one questioned it's role in the plan. But I digress.

In reality, memories are short and 20% corrections are few and far between. The stable value boomlet we are experiencing was born in the August market turmoil and will die soon after it passes. We are at the mercy of the equity market, which the average investor now embraces, and this complacency is

interrupted less and less frequently. Discussion of a rational, balanced approach to investing will be drowned out in the next wave of market euphoria. So we might as well enjoy this brief outbreak of sanity while it lasts.

But other than muddle our way to oblivion in this "new era" economy, what else can we do? We can pray for a return to the good old days of the 70's and 80's when stable value thrived on instability, uncertainty and fear brought on by big deficits, volatile interest rates and equity markets. We've suffered through the 90's as steady, responsible fiscal and monetary policy has brought more stability to the financial markets, and who needs stable value in

"EDITOR" continued on page 16.

FROM THE PRESIDENT

An Introduction and Making Stable Value Part of the Retirement Solution*Gina Mitchell, SVIA President*

I have to say thank you for giving me this great opportunity to work with you as president. We have shared an exciting and challenging two months together.

Because of the collective efforts of many members, the National Forum, highlighted in this newsletter, was a great success. Not only was the conference informative, it was both dynamic and entertaining with great speakers like Chris Matthews, Mike McCurry and Ken Kies.

"PRESIDENT" continued on page 15.

STABLE TIMES

Fourth Quarter 1998

Stable Times is a benefit of SVIA membership. Published by the Stable Value Investment Association located at 1701 K Street, NW, Suite 300, Washington, DC 20006; phone 202-463-9044; fax 202-463-7590; and www.stablevalue.com.

Editor:

Allan Fen, Fidelity Investments
617-563-5651 • allan.fen@fmr.com

Associate Editors:

Kelli Hucler, Hucler & Companies
612-941-5351 • hueler@sihope.com
David LeRoux, Jackson National Life
973-716-0794 • dave.leroux@jnl.com
Dan Libby, IBM
203-316-2160 • dlibby@us.ibm.com
Vicky Paradis, PIMCO
973-763-2502 • paradis@pimco.com
Karl Tourville, Galliard Capital Mgt.
612-677-8033 • karl.p.tourville@norwest.com

Stable Times is based on the best information and data available at the time of publication and is subject to change without notice. Opinions and views expressed in *Stable Times* are solely those of the authors and editors.

Copyright 1998

Printed in the United States of America

Back To Basics: What Do We Want A Stable Value Performance Measure To Do?

Judy Markland, Landmark Strategies

It's a fact of life that people manage to whatever is measured. Therefore, it's important that what's being reported in a stable value performance measure reflect what people want done with their stable value funds. The ideal performance measure should align the interests of the asset manager, plan sponsor and participant.

The basic objective of a stable value fund is to provide the highest risk-adjusted blended rate consistent with principal stability and maintaining the blended rate in line with market rates. The optimal SV performance measure should be designed to see that this is done as well as possible. At a minimum, this means reporting book value yields and information on the amount of both asset and plan cash flow risk transferred to the participant in generating those yields. Arguably, a meaningful performance benchmark might be the yield on a new issue, medium-term certificate of deposit.

The draft performance measure designed by the SVIA performance measurement task force is primarily intended to help plan sponsors choose among managers and to compare the relative performance of stable value asset managers. It does this quite well. However, to clarify the current value added by the manager, it focuses on market value returns and doesn't directly take account of how those returns get passed on to the participant.

SV managers will argue that they don't have any "control" over the lag in blended rates or the amount of plan cash flow risks. But let's face it. A key part of their job is to manage fluctuations in asset values and their impact on blended rates - and to take account of the potential impact of plan cash flows while so doing.

They will argue that they inherited some of these assets and should not be penalized for their performance. However, SV portfolios and vehicles are flexible enough today to allow any manager to wrap unwanted credit or option risks and to adjust out any duration or cash flow problems. In fact, a well-designed SV performance measure should be structured to encourage a new manager to wrap or otherwise neutralize any unwanted risks in the portfolio.

Benefit managers frequently complain about the difficulty of getting fixed income managers to focus on book yield and stability of principal rather than total returns. Shouldn't a SV performance objective be designed to reinforce this objective rather than to exacerbate the problem?

The recent bond market chaos has shown the inappropriateness of some exotic, option-laden investments marketed to stable value funds. Shouldn't a SV performance measure be designed to help a plan sponsor assess the potential impact on blended rates of any new investment concept?

The asset manager and benefit manager both have a fiduciary responsibility to act only in the best interest of the plan participant. The benefit manager's own performance will be partially evaluated on the success of the asset manager. Neither should have his performance and/or compensation evaluated on a basis that is inconsistent with the performance that participants see.

Perhaps the industry is large and sophisticated enough to handle two performance measures: one, calculated on book returns and measuring the degree of asset and liability risk participation, to measure how well the fund is doing relative to its objectives; and a second, using market value returns and discounting

"BASICS" continued on page 4.

"BASICS" continued from page 3.

liability risks, to measure relative performance among managers. If two methodologies aren't feasible, the measure that keeps the manager focused on the participants' objectives is the one that should be developed. It won't be as useful for evaluating relative manager performance, but it will show how well a SV fund is meeting its investment objectives.

And isn't that ultimately what this industry is all about?

Stable Value Risk Management A Checklist

Victoria M. Paradis, CFA, Pacific Investment Management Company

Risk management is certainly an appropriate theme given recent market conditions. While it is impossible to thoroughly address this topic in a few pages, this paper offers a framework for identifying and controlling the various risks of stable value funds.

The risk management process has three steps: (1) identify sources of risk, (2) determine effective measures for each risk exposure and (3) construct robust processes to control each risk.

1. Sources of Risk in Stable Value Funds

This broad list is just a start at identifying sources of risk in stable value funds:

Source of Risk	Description
Security risks	Credit, cash flow and liquidity risk
Portfolio management risks	Investment process, operational procedures and controls
Performance risks	Tracking error versus management benchmark or defacto participant benchmark (money market funds), cost of sup-optimal performance
Cash flow risk	How's today's cash flow decisions affect remaining participants
Contractual, legal, or accounting risks	This product is complex and has little tolerance for structural surprises

For a low risk fund, there certainly seem to be many sources of risk. This list really serves to highlight that controlling risk is more than simply limiting investment opportunities. The opposite is true - our industry has significantly reduced its investment risk by expanding risk opportunities into new industries, issuers and products. But how well do we manage the other risks on the list?

2. Measuring Sources of Risk

To quote Dan Libby (IBM Retirement Fund) from his June 1998 Stable Times article, "These funds cannot be considered well managed unless they are strategically directed and properly measured." This measurement challenge directly applies to risk management. To effectively manage risk, stable value funds must be able to measure their risk. While this sounds straightforward, the process is complex, as evident in the "checklist" that follows.

"RISK MANAGEMENT" continued on page 5.

"RISK MANAGEMENT" continued from page 4.

3. Controlling Risk

Development of an Investment Policy Statement is an excellent start toward controlling a fund's risk. Effective Investment Policy Statements are common in the traditional pension world, but are hard to find in the stable value world. Such documents serve as a management tool that records important decisions and provides a "road map" to future decision-making. A Policy Statement should include fund objectives, asset or product allocation, benchmark(s), evaluation criteria, and clearly defined triggers for implementing changes in manager or policy. An Investment Policy Statement should be both thorough and flexible.

From a plan sponsor's perspective when implementing the investment policy, three tools can control much of the risk. First, plans must perform thorough due diligence when selecting a bond manager or stable value manager. This process should result in a good understanding of the selected manager's investment process, organizational structure, and performance record. Second, well-designed investment guidelines control the "investment risk budget" in managing the securities. Third, plans must regularly measure and assess both the fund's risks and its performance. All three steps are necessary to fulfill a plan sponsor's minimum fiduciary duty.

From an investment manager's perspective, a sound investment process and organizational structure must be in place. Computer systems resources are clearly an important tool for controlling investment risk. A manager's systems resources should span the risk spectrum from individual security analysis to aggregate portfolio exposures. With respect to individual security pricing, models can be useful in aiding in purchase and hold decisions. Systems are powerful in their ability to model and stress test securities under a range of scenarios, including best and worst cases. However, managers should not use such analytics in a "black box" framework, as systems should serve as tools to aid in investment decision-making, not to drive decisions. In addition, the evaluation should not end after a security is purchased. Managers should regularly reevaluate portfolio holdings, as the decision to hold is as critical as the initial decision to purchase.

Room for Improvement

The industry's risk exposure and management have certainly improved from the days when we could only invest in insurance company GICs. Yet there remain many areas in need of improvement.

Here's a list of questions to help any plan clarify and improve its risk management process:

Security and Portfolio Risks

- Do you measure investment risks at the security level and consolidate them at the fund level?
- What are your fund's average duration and credit quality? Do you control these characteristics with clear investment guidelines?
- Is your portfolio managed with the help of sophisticated and flexible systems that allow for stress testing?
- For marketable securities, does your manager obtain unbiased analytical evaluations and risk measures that are not affected by its own market views?
- Does your manager provide accurate and timely reporting which gives insight into the strategies being applied as well as the opportunities and risks they represent?

Portfolio Management and Operational Risks

- Does your manager have a well-defined investment philosophy?
- What controls enforce the investment process?
- What is your manager's organization and incentive structure?

"RISK MANAGEMENT" continued on page 6.

"RISK MANAGEMENT" continued from page 5.

- Does your manager have clear lines of reporting and segregation of non-compatible functions (such as trading, settlement and accounting)?
- Does your manager have a dedicated and independent compliance group, and procedures for resolving compliance issues?

Performance Risks

- Do your investment guidelines appropriately balance the conflict of this "conservative" vehicle that also has long-term retirement investment objectives?
- What is your fund's management benchmark?
- Can you precisely measure and evaluate your fund's performance?
- Can you determine sources of value-added?
- What sources of tracking error does your fund have versus money market funds — which is your participants' de facto benchmark?

Cash Flow Risks

- When and to what degree does your fund self-insure withdrawal risk, such as by withdrawing from participating contracts or using natural fund cash flows to cover withdrawal needs?
- When and to what degree does your fund pass withdrawal risk to a third party, by directly tapping GICs or non-participating wrap contracts?
- What is the financial impact on your fund of its withdrawal risk?
- Can you determine when withdrawal risk will be profitable to your participants and when it will be detrimental?

Contractual, Legal or Accounting Risks

- What events in your portfolio or plan could generate market value adjustments to your fund?
- Do you know the exit provisions in your contracts?
- Are ERISA and other regulatory requirements satisfied completely in your fund?

In sum, effective risk management requires focus by both the plan sponsor in designing and monitoring the fund, and by the investment manager in developing sophisticated measurement tools and in communicating with clients. It is important that advanced risk management processes lead the way in the stable value industry's continuous evolution.

Trends in Stable Value Systems and Operations: Electronic Fund Statements

Terry Finan, Jackson National Life

Over the past several years, several discretionary GIC managers have begun requesting issuers of stable value contracts to provide electronic data on a monthly basis as a replacement for paper fund statements that communicate changes in contract value.

How It Works

Issuers provide a data file which has a consistent structure from month to month. The data typically provided includes beginning and ending balances, interest credited and a summary of each cash flow under the contract during the reporting period. This information is extracted from the issuer's computer system,

"TRENDS" continued on page 7.

"TRENDS" continued from page 6.

transmitted to the manager electronically and then imported into the manager's portfolio management system. The manager then has the ability to run detailed reports identifying which contracts have deviations from expectations provided from their own systems.

Actual Experiences

Suzanne Inmon has responsibility for implementing an electronic fund balance initiative at PRIMCO Capital Management in Louisville, Kentucky. She reports that issuers have approached PRIMCO's request for this data very enthusiastically. The issuers recognize that they will enjoy significant cost savings over the lives of their contracts due to the elimination of the paper stock, printing, insertion and mailing costs previously required for the monthly preparation of paper fund statements. She estimates that receiving this data feed from approximately 12 major issuers has cut PRIMCO's statement review time by 85%.

Fidelity Investment's stable value management group has been receiving monthly electronic data transmission feeds of contract information for about four years. They currently have seven issuers participating and another is about to join on. The feeds from the current issuers arrive by the fifth business day of a month with the prior month's data, providing information on about 70% of their stable value contracts. The feeds allows for automatic monthly reconciliation with their contract portfolio management system. That system then feeds the daily stable value fund interest accrual information for each plan to their participant record-keeping operation.

Some Thoughts

Currently there are several different data formats being used in the stable value industry. It may make good sense to attempt to standardize this format. Perhaps a Stable Value Investment Association supported format would increase the awareness across the industry. Once this standardized format is adopted, others may choose to integrate this capability into their systems knowing that major issues have already been ironed out. Plan sponsors, trustees and record-keeping organizations which receive GIC balance information in order to report values to plan participants could also benefit from these data feeds.

Due to the large number of these organizations compared to GIC managers, it may make sense for issuers to report this information in a standardized format to a central location. Perhaps the most appropriate hub would be a security pricing service such as Bloomberg. There each contract could be issued a unique identifier similar to a CUSIP. From the pricing service, the balance and cash flow data could be retrieved and fed into any system including a trustee's holdings valuation system. By making stable value contracts' values available like other fixed income instruments, we as an industry may be able to remove some of the administrative complication that surrounds stable value products and make them more user-friendly.

I would be interested in readers' views and insights on this topic. Please e-mail me at: Terry.Finan@jnli.com

How IBM And Its Employees Use Stable Value

Duncan Osborne, SVIA Freelance Writer

Participants at IBM primarily use their stable value fund to preserve assets and earn a guaranteed return as they approach retirement. They also use stable value to meet their near term investment objectives such as purchasing a home or saving for college.

"It's about 50 percent evergreen and about 50 percent maturing assets," says K. Daniel Libby, CFA, and

"STABLE VALUE" continued on page 8.

NEWS FROM SVIA

SVIA's 98 Media Highlights on CDROM

ABC's Wall Street Report along with CNBC and CNN coverage are a few of SVIA's recent media highlights. SVIA has put this positive coverage on CDROM for your viewing. SVIA sent each voting member one copy of the 98 Media Highlights. An additional copy is available upon request. However, multiple copies must be purchased at a cost of \$15 per disk and there is a five disk limit. SVIA's 98 Media Highlights is a crucial component to our 1999 public education and membership outreach campaign.

Save October 12-14, 1999 for SVIA National Forum

Mark your calendars now for SVIA's 1999 National Forum: October 12-14 (Tuesday to Thursday). Next year's forum will be held at the Monarch Hotel in Washington, D.C.

SVIA Responds to Inquiries on Stable Value

SVIA answered over 300+ inquiries from ABC's Wall Street Report on stable value with "Your Questions Answered about Stable Value," a SVIA brochure which explains stable value investments. The brochure, which is enclosed, provides a broad overview of stable value by answering basic questions individual consumers and defined contribution participants may ask.

1998-1999 Membership Directory

SVIA released the 1998-1999 membership directory to each voting member of the Association. In addition to putting SVIA's membership at your finger tips, the new directory provides a quick reference on SVIA's mission, membership benefits, committees, and the Board of Directors. SVIA has a few remaining copies which are available to the membership on a first come basis for as long as the supply lasts. To request additional copies of the directory, please call SVIA at 202-463-9044.

"STABLE VALUE" continued from page 7.

Investment Manager for IBM's \$3.6 billion stable value fund. "The thing about the stable value fund that our participants find valuable is that it always earns a positive rate of return."

Roughly fifty percent of the participants in the stable value fund are receiving bridge benefits or are retired. The other half are active. The average age is 55. This explains why almost half of the portfolio in guaranteed investment contracts and the rest is in constant duration portfolios of bonds.

"The way we set up the portfolio was by looking at the demographics of the participants and their historical cashflow activity," Libby says. For the year prior to September 30, the stable value fund returned 6.45 percent.

IBM's \$15.0-billion, Tax Deferred Savings Plan, the company's 401(k) plan, offers 206,000 active and retired participants eleven investment options including the stable value fund.

There are four equity funds, including an IBM stock fund and three index funds for large company, small company and international equities. On the fixed income side, IBM offers a money market fund, currently with \$450 million in assets, and an index fund tied to the Lehman Aggregate Bond Index. Only the stable value fund is managed in-house.

"The other funds, because they are all index-based, are managed by an out-of-house manager," Libby says. IBM also offers four life strategy funds that mix assets between the other seven choices.

For the year prior to September 30, the IBM stock fund was up 21.7 percent, the small company and international stock funds were down 11.9 and 13.1 percent, respectively, and the large company index fund was up 11.3 percent. For the same period, the bond fund and money market fund were up 11.3 and 5.6 percent, respectively.

"DEBATE" continued from page 1.

including equities in a stable value portfolio. No one at the symposium supported adding commodities or managed futures in a stable value portfolio.

"We, historically, have really not even taken the idea of introducing equities into stable value portfolios too seriously," explains Karl P. Tourville, a Managing Partner at Galliard Capital Management. "I would say that now is not the time to look at new asset classes. The participants out there are expecting rock solid returns. Who am I, as a manager, to decide that they need equity exposure?"

Indeed, participants are choosing a stable value option for its predictable return and the safety of their principal. They are "savers" who want to avoid risk. The recent, stock market volatility may only increase their aversion to equities.

"We as an industry should be very careful about 'diversifying' into equities or other new asset classes. While the returns associated with these asset classes may be uncorrelated with interest rates, they are also apt to introduce unanticipated volatility into a stable value fund," concludes Jacqueline Griffin, the Chief Actuary at Diversified Financial Products.

Stable Value Enters Mutual Fund and IRA Markets

Bankers Trust recently launched two stable value mutual funds. "One was developed for the institutional market and the other was developed for the IRA market, the individual market," Psome explains. "The landscape is definitely shifting towards a mutual fund provider environment and stable value was the only option...not covered in mutual fund format."

The format is a "liquid bond portfolio" that does not have the traditional guaranteed investment contract, or GICs, that would fall into an illiquid basket. Equities can add greater liquidity. The duration in the portfolios is slightly longer than a traditional stable value fund and the funds have a "global wrap." The funds have their own ticker symbol that participants can check on-line or in their daily paper.

"On the IRA side, we think this is really something that folks are going to be excited about when they retire if they've enjoyed the luxury of a stable value fund in their plan," Psome predicts. The IRA option allows participants to move their assets into a fund that is less risky than an equity fund and will generally outperform a money market fund, by about three percent, over time.

"The biggest boom for stable value, as an industry, will come from the ability to tap the IRA and the IRA-rollover market which is somewhere around \$115 billion which now moves into money market funds," Psome asserts.

Global Outlook for Stable Value

New markets for stable value products were also a part of the symposium's focus as well. While the financial services industry is eyeing the globe, much of the world has yet to discover stable value investments.

"I see a lot of demand for guaranteed products internationally," states Galliard's Tourville. "There's interest in Japan, there's interest in Canada, there's interest in Latin America...I would say that the future looks bright for managers who look beyond traditional markets."

Looking North to Canada

The Canadian market is sizable, but still dominated by defined benefit schemes. As of 1997, \$528 billion, in Canadian dollars, was held in defined benefit plans. In 1986, 92 percent of the work force had their retirement assets in a defined benefit plan. That number has declined to 87 percent in 1997. However, there has been a dramatic rise in mutual fund assets, which have increased in Canadian dollars, from \$187.5 billion in 1996, to \$289.8 billion this year.

The market, nevertheless, presents some unique issues for stable value, not the least of which is that GIC providers in Canada already offer some innovative products that allow investors to participate in equity markets while guaranteeing the investor's principal.

These are "GICs with guts," according to John Appleton, a Senior Vice President and Senior Investment Consultant with Fidelity Institutional Retirement Services. Typically, these GICs carry maturities of two to five years with a rate that can be tied to the Morgan Stanley World Index, the Standard & Poor's 500 Index or the performance of the Toronto Stock Exchange. The products are sold to both individuals and institutions.

"Compared to the bold Canadians, we in the U.S. seem to be accepting of a very reduced role of GICs in retirement investing," Appleton says. "They had GIC products that appealed to young people."

There are also regulatory hurdles that providers face, according to Jennifer Northcote, a Partner at Stikeman Elliott, a Toronto law firm. First, the regulation of securities and investment products is left, primarily, to Canada's ten provincial governments which, increases the complexity of operating in the market and may increase the costs. For example, like the U.S., investment advisors and dealers are required to be registered. In addition there are prospectus requirements to consider.

"Typically, for offshore products or U.S. products being managed outside Canada or sold in private placement in Canada, legal practitioners are of the view that portfolio managers of the product do not have to be registered in Canada," Northcote remarks. Ontario is the exception to this registration rule.

"If you sell an offshore mutual fund to an Ontario resident, you are deemed to be advising that Ontario resident," Northcote says, and need to consider advisor registration requirements.

Most important is the foreign content limitation Canadian law places on pension schemes and tax-deferred plans. A maximum of 20 percent of assets, by cost, may be invested in non-Canadian property. Canadian investment managers continue to lobby to change this restriction.

"The managed product market is becoming more and more competitive," Northcote states. "The fees are dropping, principal protection is varying...insurance products are offering more re-set options and shorter maturities."



CNBC's Host of "Hardball" shares a lighter moment before he begins his luncheon remarks with SVIA Chairman John Milberg.

Looking to the Old Country, Europe

The European market also received significant attention from SVIA Forum participants. The January 1, 1999



Top: Mike McCurry, President Clinton's former press secretary, takes a few additional questions after his luncheon address.

Right: Senator Rod Grams (R-MN) discusses Social Security reform and gives his views on how Social Security should be fixed.



launch of a common currency for 11 European countries is expected, in some circles, to create a huge market and a powerhouse economy.

"The possibilities are dazzling," says Jonathan L. Mercier, a Partner at Turco and Mercier, a law firm. "I'm not going to tell you how to make a killing in this market or who are going to be the winners and losers because quite frankly I don't know. That is very hard to predict. What is easy to predict is you ought to see some real dramatic changes in that market over the next couple of years and there ought to be some real, dramatic opportunities."

The European pension market, according to Mercier, has some \$3.0 trillion in assets. Those assets are held, largely, in defined benefit plans. GIC products, Mercier notes, were originally a

tool for the defined benefit market.

The picture, however, is not entirely rosy. The United Kingdom holds one third of those pension assets.

"It is also the one that has a pension system that is most similar to the one we have in the United States," Mercier remarks. "In the United Kingdom, they are committed to equities...It's a big market, but it's not the best market in the world from a stable value perspective."

There is a growing movement towards defined contribution plans in Europe, according to Mercier, with defined contribution plans making up roughly ten percent of plans in the United Kingdom. The launch of a common currency may speed the development of a defined contribution market. Employees may come to expect pension assets that are portable not just from employer to employer, but across national borders.

"It is very, very hard to provide meaningful portability if the basis for your pension program is a defined benefit scheme," Mercier says. "It is much easier to provide portability if your core pension program is a defined contribution. I do think that, over time, it is going to move Europe...to a defined contribution scheme. It is not going to happen quickly."

Another driver towards defined contribution plans is underfunding of defined benefit plans. European public plans, like the U.S. Social Security system, are pay-as-you-go. They use a "book reserve" method, according to Maarten Nederlof, a Managing Director at Deutsche Bank Securities. In other words, they simply make note of the liability.

The result is Europe faces staggering liabilities. Germany's unfunded pension liabilities are equal to four times

its gross domestic product, according to Dr. Lars Norup, Head of Northern Europe Derivatives Marketing at Greenwich Natwest. In France, those liabilities equal three times that country's gross domestic product. In contrast, the U.S. liability is equal to three percent of our nation's gross domestic product.

"Many of them are actually technically bankrupt if you use U.S. accounting standards," says Nederlof. "One of the key issues is if pensions are going to start really funding up and investing in capital markets what are they going to invest in? It turns out that the corporate bond markets and equity markets in Europe are really rather small."

In Germany, for instance, bank lending accounts for 99 percent of corporate funding. In contrast, 36 percent of corporate funding comes from bank lending for the U.S. Additionally, European pension funds are restricted in where they can invest. Lacking cash, some European governments are enacting policies that favor private plans, according to Nederlof.

The dearth of investment products could be an opportunity for stable value. "Europeans just don't dig stocks the same way that Americans do," Nederlof remarks. "Europeans tend to prefer guaranteed pensions...For the most part, fixed income instruments, interest savings accounts, annuities tend to really dominate pension schemes in Europe...We know Europeans like guaranteed investments, in theory, therefore they should be much more interested in stable value type products compared to the U.S."

Entering the European market, however, and competing there will not be easy, according to Dana Troxell, a Vice President with the Goldman, Sachs Asset Management Advisory Group. Europe comprises, roughly, one third of the global investment management market and 80 percent of those assets are managed by European banks and insurance companies.

"It's become a very capital intensive game," Troxell reports. "What will rise in importance is brand identity and access to capital...For those companies looking to expand abroad, it's going to be a very, very tough fight...We believe that international expansion — Europe, Asia, Latin America - is going to be considerably more difficult than we thought three or four years ago."

Media Challenge: Getting Coverage in a Bull Market

Charlie Ruffel, Editor-in-Chief of Plan Sponsor magazine, challenged the industry to seize these new market opportunities. He urged participants to learn from the success of large mutual funds who have used branding to establish market position, noting that the bull market has also played a role in their success. "They've done that on the back of aggressive branding," Ruffel asserts.

The financial press is starry-eyed over equities advises David Albertson, the Editor of Employee Benefit News. Albertson notes its hard to get the press to focus on stable value in a "smart equals stock" environment.

That is changing, according to SVIA's Chairman John E. Milberg, a Senior Vice President of the Institutional Products Group at the Pacific Life Insurance Company. "If you think back about what's happened in our industry, there's been some good things and some bad things," says Milberg of SVIA's ten-year history. "I believe the media stories are now in our favor...We have come a long way and it's a positive path..."

U.S. Social Security Participants: Another Market?

Depending on the result of Social Security reform, the U.S. may become a very large market. One reform

proposal would establish a personal retirement account for each U.S. worker and fund those accounts with two percent of annual earnings up to Social Security's current limit of \$68,400. By one estimate, that plan would create 147 million accounts.

Social Security was signed into law in 1935 and established as a pay-as-you-go system with contributions from current workers and their employers funding the benefits of retirees. The system has generated surpluses since 1983. However, there has always been significantly more workers than retirees. Those surplus funds have been invested in U.S. Treasury bonds. The estimated revenues for the Social Security Administration in the 1998 calendar year, excluding Medicare income, will reach \$426.7 billion. The system will have a surplus of \$57.6 billion in 1998.

The ratio of workers to retirees hit its peak in 1950 with 16 workers for every retiree, according to a 1997 "white paper" from Towers Perrin, a benefits consulting firm. It has shrunk to 3.3 to 1 in 1996 and is expected to fall to 1.8 to 1 by 2030. In 2013, income will fall below benefit payments and the system will begin spending down its surplus. By 2032, Social Security will have income to pay only 75 percent of its promised benefits.

Key public interest groups agree on the need for Social Security reform. In fact, the American Association of Retired Persons (AARP) who has over 30 million members supports Social Security reform. Organized labor has also signed on. In August, the Executive Council of the AFL-CIO, which represents some 15 million workers, endorsed "seven fundamental principles" that should guide reform.

Agreement stops there. The debate is just beginning on the extent of the Social Security's problems and potential solutions.

Michael Tanner, the Director of Health and Welfare Studies at the Cato Institute, a conservative think tank, put Social Security's unfunded liability at \$10.0 trillion. While U.S. Senator Rod Grams, a Minnesota Republican, tagged the liability at \$20.0 trillion.

"What we do agree on is that we need some pre-funding," says Dr. Wendell Primus, the Director of Income Security at the Center on Budget and Policy Priorities, a liberal think tank.

Tanner argues for individual accounts only. Primus supports a government run trust that invests broadly in financial markets. Grams argues for a "fully, personalized retirement system" with up to ten percent of earnings invested with a government-approved provider. "In my plan, we call for setting up a board to create rules and regulations that these companies would have to abide by," Grams says. The funds could only be used for retirement.

J.P. Morgan to Host Retirement Reception for Murry Becker

The stable value group of J. P. Morgan Investment Management Inc. will be hosting a reception in Murray's honor on December 7th from 5:30-7:30 at The Penn Club in NYC. The cost per person is \$50.00, and to register for the reception an advance payment via check must be sent to J.P. Morgan by November 25th. Anyone interested in attending should make their check payable to Alexander Fitzburgh and mail it to:

Claudia Sievert
J.P. Morgan Investment Management Inc.
522 Fifth Avenue -5th Floor
New York, NY 10036

Questions regarding the reception should be directed to Claudia at 212-837-5274 or e-mail her at sievert_claudia@jpmorgan.com.

"I think we should be looking for reform probably past the year 2000," predicts Senator Grams. Kenneth J. Kies, a Managing Partner at PriceWaterhouse Coopers and the former Chief of Staff of the Congressional Committee on Taxation, sees a more immediate possibility.

"My own view is if we don't get this done in the first nine months of next year the window will close," Kies says. The current budget surpluses, give Congress room to take up a tough issue like Social Security reform.

"President Clinton's going to be looking for his legacy," Kies states. "The president is clearly very aware of how he could be portrayed in history and it is not a pretty picture. Social Security reform may well prove to be his chance to redefine his place in history."



*David Perry,
conference co-chair
introduces a speaker.*

Role of Pension Reform Unclear in Social Security Debate

How the pension industry will fare in the Social Security debate is an open question. The industry was unable to move legislation through Congress this session despite some 50 to 60 bills pending, reports Lynn Dudley, Vice President at the Association of Private Pension and Welfare Plans.

"I was disappointed there was no pension legislation this year," Dudley says. "On the other hand, I was not really surprised. In order for pension legislation to be passed you've got to have a lot of people singing from the same sheet."

Market Outlook: More Volatility in Equities & Low Interest Rates

According to Edward S. Hyman, the Chairman of ISI Group, 1999 will see more volatility in equities and low interest rates. "The feeling that I have for next year is that it's going to be a tough year," Hyman predicts. "There are probably a half dozen markets that are signaling that something is coming."

A Look at the Life Insurance Industry

A recent study by Moody's Investors Services found the life insurance industry on solid financial ground when comparing GIC and bond default rates as well as recoveries. "What it shows is that the life insurance industry does pretty well," Keven W. Maloney, a Vice President and Senior Analyst at Moody's. "We think the life insurance industry is a high quality industry, and definitely the highest in the financial services industry."

The cumulative life insurance insolvency rates from 1988 to 1997 were just above investment grade credits and substantially better than corporate bonds. Also, GIC default rates since 1980 were less than both investment grade defaults and all corporate bonds. Recoveries in the life insurance industry were exceptional, Maloney found. GIC investors in Executive Life, Mutual Benefit Life and Confederation Life, on a discounted present value basis, recovered an estimated .70, .96 and .90, respectively, on the dollar excluding any state-guaranteed payments. Bank loans, the next closest category, paid .70 cents on the dollar.

However, Maloney sees challenges ahead for the industry. He cautions, "We're seeing very low levels of growth in life insurance sales with a lot of companies chasing too few customers. The insurance industry also has a mixed record on customer service and cost control."

SVIA Honors Murray Becker

Murray Becker recognized as the founder of stable value was honored at SVIA's Forum. Mr. Becker, who

currently serves as Vice President at J.P. Morgan, reflected on the origins of stable value. "In 1972, a client asked me to develop a safe product for plan participants...Out of this we built an industry," muses Becker.

Becker had some advice and hopes for his colleagues as he approached his upcoming retirement at the end of this year. "Stable value investments have to be good for the customer. We have to make money at it too...There's always a role for a traditional product that guarantees principal and preserves a much higher rate of savings. At J.P. Morgan, we have seen plan sponsors return to stable value to the tune of \$4.0 billion in just the past four months."

Please note J.P. Morgan is hosting a retirement party on December 7 for Murray. For more details, see page 13 of Stable Times.

SVIA Effort on Proposed Class Exemption For Synthetic GICs Explained

SVIA is seeking a Department of Labor class exemption for synthetic GICs. The proposed exemption, when granted, will permit a synthetic GIC issuer, or an affiliate, to also manage the assets of the contract. Currently, synthetic GIC issuers encounter ERISA prohibited transaction constraints when seeking to manage assets and provide a synthetic wrapper. ERISA section 406(a) prohibits party-in-interest transactions and 406(b) bans what might be called self-dealing. The exemption request comes at a time when, increasingly, plan

sponsors want one-stop shopping, increased efficiency and reduced costs for plan participants.

"PRESIDENT" continued from page 2.

Many thanks go to the Program Task Force and the Sponsors and Patrons. A special thanks to John Milberg who guided the meeting and David Perry who was a wonderful co-chair. It was a pleasure meeting all 240 of you even if it was a bit daunting and over such a concentrated time—two and a half days.

SVIA is in an enviable position. The industry has a great story to tell and the timing is right. Baby boomers are struggling to: save and (some) even pay for their children's college tuition, take care of aging parents and anticipate their own retirement needs. After almost seven and a half years of an equity market that stayed up, it went down and became a roller coast ride, thanks to the return of market volatility. As belief in aliens steadily increases, the public and their elected officials also seem to be realizing that Social Security was never meant to be the only source of retirement income.

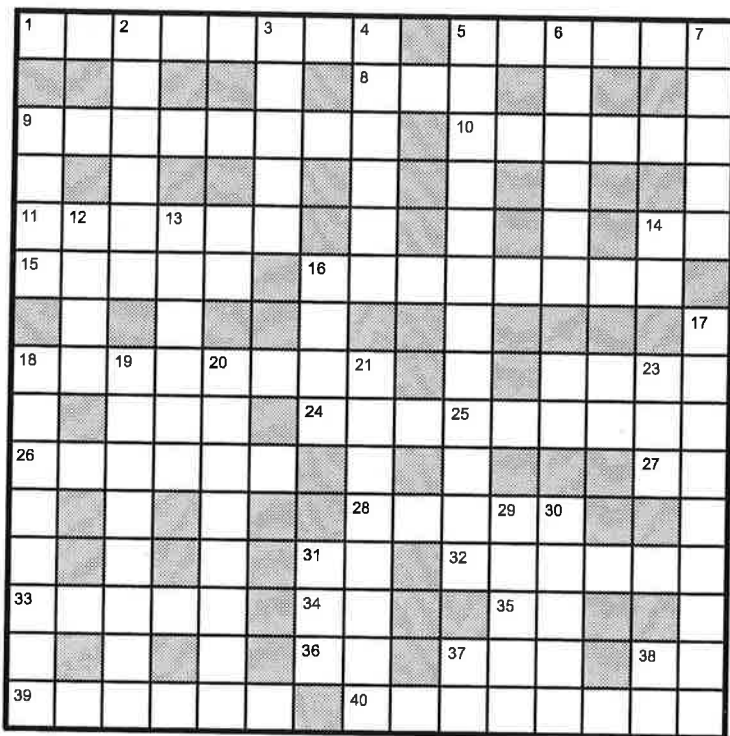
These events give SVIA the opportunity to tell the public how stable value can be used to build retirement security and to participate in the national retirement debate. I look forward to working with you to ensure that SVIA is part of the retirement solution.

"We're hearing from members that there is a trend line towards wrappers and managers being one and the same," says Alfred A. Turco, the Chairman of SVIA's Government Relations Committee and a Partner at Turco and Mercier, a law firm. The Labor Department is concerned about the potential of abuse, specifically, self-dealing or fiduciaries using plan assets for their own benefit.

Al Turco and Steve Saxon, a Principal at the Groom Law Group, explain that the Department's concern with potential self-dealing can be overcome through some give up of discretion by the GIC issuer and with greater disclosure to the plan. However, if the disclosure requirements are too extensive or onerous, plan sponsors will be less inclined to buy synthetic GICs.

"We want stable value products to be offered in 401(k) plans and other defined contribution plans consistent with other products out there. We are more than happy to provide meaningful disclosure just like anybody else," explains Saxon. "However, if we end up with disclosure requirements that go beyond 404(c), that creates a problem for everyone," concludes Saxon.

CROSSWORD PUZZLE



ACROSS

- 1. below par
- 5. type of payout structure
- 8. fish eggs
- 9. investment
- 10. superannuate
- 11. group of singers
- 14. doctor (abbr.)
- 15. rubber auto parts
- 16. approach, style
- 18. invest with borrowed funds
- 23. hospital room (abbr.)
- 24. senior officer
- 26. type of bond
- 27. New Jersey town (abbr.)
- 28. Godzilla's winged rival
- 31. copy (abbr.)
- 32. stable, fixed
- 33. piece of furniture
- 34. famous number
- 35. motor home (abbr.)
- 36. to be
- 37. lace
- 38. press syndicate
- 39. kind of madness
- 40. democratic principle

DOWN

- 2. asset class
- 3. parts
- 4. audition
- 5. man's name
- 6. small
- 7. pattern
- 9. faction, cult
- 12. bee's home
- 13. renounce
- 14. possessive
- 16. desert plant
- 17. worry
- 18. "Purple Sage" hero
- 19. type of annuity
- 20. fetch
- 21. work out
- 22. New England state (abbr.)
- 23. woman's name
- 29. atriums
- 30. belly button
- 37. you (Spanish)
- 38. preposition

"EDITOR" continued from page 2.

times like these? It's always possible that things could change again, but I wouldn't bet our livelihood on it.

One thing that is clear from observing successful political or public relations campaigns is the importance of a simple, well-packaged message and the ability to "stay on message". Substance is almost secondary. Remember "Morning in America," "Where's the Beef," "Contract with America" and "Bridge to the 21st Century?" This year it was "Enough is Enough, Kenneth." In an age of ever shorter attention spans, even the most worthy cause gets buried if not well packaged.

Stable value needs such a simple message and the discipline to reinforce that message in palatable "sound bites" at every opportunity - press, interviews, letters to the editor. Here's my first crack at such a message.

Retirement Savers,

- A balanced investment strategy is the best approach, and
- Stable value is crucial to achieving good balance.

Not exactly poetic. I'm sure someone can do better. Send your ideas along to Gina. A lifetime subscription to *Stable Times* goes to the winner. "Just do it."

Look for the next issue of *Stable Times* (First Quarter, 1999) in February of next year. All readers and SVIA members are encouraged to submit articles to include in the newsletter. *Stable Times* is a "member publication." Not only is it for you, you also write it!

If you have ideas for future issues or articles that you wish to write, please contact Allan Fen at 617-563-5651/allan.fen@fmr.com or Gina Mitchell at 202-955-4362 gmitchell@svia.com. All articles for the next issue of *Stable Times* (First Quarter, 1999) must be submitted in final form by January 31, 1999 to Allan or Gina.