SVIA STABLE TIMES

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Consolidation Transforming Stable Value Business Into the Few and the Strong

By Randy Myers

The long-running consolidation of the financial services industry has finally begun to transform the stable value landscape.

Last year, insurance industry giant American International Group Inc., a big player in the wrap business, completed its merger with SunAmerica Inc., a large issuer of traditional GICs. This year, Germany's giant Deutsche Bank will acquire Bankers Trust Corp., to create the world's largest banking entity and a formidable presence in the book value wrap marketplace. Also scheduled to join forces this year are Dutch insurer Aegon N.V., which sells guaranteed savings and investment products through its Diversified Financial Products group, and Transamerica Corp., a smaller but also significant player in the wrap business.

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Consolidation of the Financial Services Industry: ERISA Implications

Donald J. Myers, Partner, Reed Smith Shaw & McClay LLP

The past 10-15 years have witnessed significant consolidation in the financial services industry. In addition, firms in one segment of the industry that were once restricted from other segments are now able to branch out into new areas, due to changes in their governing laws at the legislative or regulatory levels.

One of the laws that requires attention in connection with these changes is the Employee Retirement Income Security Act of 1974 (ERISA), the federal statute governing the management and administration of private employee benefit plans. The fiduciary responsibility provisions of ERISA include a series of "prohibited transaction" rules, which restrict the ability of a plan fiduciary to engage in certain activities.

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Stable Value and the Internet

Judy Markland, President, Landmark Strategies

In recent strategic planning sessions that Landmark has structured for investment clients, the biggest future challenges inevitably seem to be posed by the Internet. Savvy institutional investors can see significant shifts in their customer communication and purchasing patterns. Since this type of change will affect the stable value industry as well, it's useful to review some basic theory about the effect of the web on business as a whole and the current picture of stable value on the web.

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EDITOR'S CORNER

Karl Tourville, Managing Partner,
Galliard Capital Management

The major secular trends of our times, globalization (and resulting consolidation), technology, and demographics have, and continue to exert a significant impact on our lives and professions.

While the old Chinese adage "may you live in interesting times" is often cited and used to characterize this day and age, it nonetheless applies more today than perhaps at any time in history. The major secular trends of our times, globalization (and resulting consolidation), technology, and demographics have, and continue to exert a significant impact on our lives and professions.

This issue of Stable Times reflects these dominant trends. It is wide ranging, and filled with current, in depth information and analysis of some of the major issues currently impacting the Stable Value industry.

The issue leads with two pieces on consolidation in the financial services industry. Randy Myers joins us once again with an informative piece discussing how continued mergers and acquisitions is transforming the stable value marketplace for buyers and issuers. Donald Myers, a partner with Reed Smith Shaw & McClay LLP, complements Randy's piece with a discussion of the implications of consolidation from an ERISA perspective.

Another theme of this issue is, not surprisingly, stable value on the Internet. We have a trio of articles relating to the impact and opportunities posed by the Internet. First, Judy Markland of Landmark strategies provides a compelling article on how web use has changed provider/customer relationships and thereby demonstrates the necessity for more participant oriented information on web sites. Nell Hennessy of ASA dovetails on Judy's piece with an examination of the benefits of web sites and the importance of making interactive tools with stable value included available to investors. The third installment is by John Milberg of Pacific Life who presents the results of the recent SVIA survey on electronic commerce. As you can guess, the article confirms what we all know by now – web commerce is here to stay.

The issue is rounded out with articles from SVIA President Gina Mitchell, and Jon Fraade of AIG Financial Products. Gina's piece, which was penned for an upcoming issue of Profit Sharing Magazine, stresses the key role of stable value in diversified portfolios and the need for stable value to gain acceptance as an asset class distinct from bonds and money market funds. Jon discusses the application of stable value wraps for the Corporate-Owned Life Insurance (COLI) and Bank-Owned Life Insurance (BOLI) markets.

If this isn't enough, you can also digest the results of the1998 SVIA-LIMRA Guaranteed/Stable Value Product Sales Survey which among other things reports that sales posted their largest increase in five years, to over $75 billion!

So, enjoy the issue and continue to live in interesting (and stable) times! ❖

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"Few and the Strong" continued from page 1

Fewer Players

"These combinations are in and of themselves somewhat interesting, but it's even more interesting since a few other providers have gotten out of the business," observes Karen Onderko, a director of Deutsche Bank's New York Branch and manager of its Benefit Responsive Products Group, which has about $7.25 billion of mostly wraps on its books. "I think we reached a point where a lot of providers looked at the stable value market, the level of pricing, and the terms people were asking for, and concluded that if they didn't already have a decent-sized book of business it would be hard to support this activity going forward."

Many industry insiders see this new trend continuing.

"The traditional GIC side of the business is going to be dominated by the biggest, strongest players, and those companies that continue to focus on the narrowest of markets will continue to shrink," predicts Lin Grey, vice president of group products for SunAmerica Life Co., which is responsible for the company's GIC activities. "But I don't think we're going to get to the point where we have just one or two competitors. I think there will continue to be a number of very strong competitors."

Impact on Pricing Seen Negligible

Grey's view suggests that while there may be fewer providers of stable value products, there's no indication that capacity will be reduced, and hence little if any near-term impact on pricing.

"The biggest determinant of traditional GIC pricing is the appropriate spread to Treasuries relative to the insurer's ratings, and the ability of the insurance companies to invest their monies at an attractive spread to meet their return hurdles," says Grey. "I think that drives pricing much more than the number of players."

"I'm not sure consolidation will have a direct effect on wrap pricing," adds Onderko. "On the other hand, wrappers must negotiate terms that are fair to both their clients and their own organization, and I believe there will be a greater focus on contract terms by wrappers going forward."

Credit Risk Concentration: Tradeoffs Likely

While consolidation will put more stable value assets in the hands of fewer players, it also will provide new marketing opportunities for some smaller providers, as plan sponsors scurry to make sure they don't have excessive credit exposure to any one insurer or bank. That shouldn't be too hard, since most contracts have explicit exit provisions that allow the plan sponsor to terminate the relationship with the provider. (Though an early exit may trigger a penalty payment.)

The size of some of the newly combined entities in the stable value marketplace will be rather dramatic. Jon Fraade, vice president with AIG Financial Products, notes that based on numbers compiled by Galliard Capital Management, Diversified Financial Products and Transamerica combined had about $17.1 billion in synthetic GIC and wrapped assets outstanding at year-end 1997. A combined Deutsche Bank and Bankers Trust would have had about $16.7 billion outstanding at that time in synthetics and wraps. The next biggest provider would have been J.P. Morgan, with $7.6 billion.

"What you see is that these two entities (Deutsche/BT and DFP/Transamerica) are becoming huge players relative to everyone else," Fraade says. "But stable value managers generally have diversification requirements that prohibit them from having any more than 5% or 10% of their stable value assets in any one wrapper. We're already seeing transactions where people are unwinding existing contracts with other providers and asking us to replace them."

Onderko does not see credit-risk concentration becoming a significant problem for Deutsche Bank and Bankers Trust, however. "We were happily surprised to find that the overlap between our book of business and BT's book of business was only about 20%," Onderko notes. "And my sense from speaking with clients in that 20% category is that most are happier about the fact that their new counterparty is a bigger, more diversified institution than they are concerned about the fact that their exposure to a single organization is increasing. But there will be clients who will face concentration limits, and we will need to address those issues after we merge the two books."

Grey says there was little overlap between the traditional GIC business at SunAmerica and AIG.

"There were maybe one or two (pension) plans that had a GIC investment with both companies, but it was a rarity," Grey says. "More importantly, we were rated AA-, and now we are rated AAA as a result of our merger. That has allowed us to enter markets we were previously prohibited from entering based on our rating, and opened a lot of opportunities for us. Prior to the merger, we depended on innovation to grow our business. Now we have the innovation, plus the highest credit rating."

The Merger Experience

While it is impossible to say what challenges will confront Deutsche Bank/Bankers Trust, and Aegon/Transamerica when they merge, the experience of AIG and SunAmerica seems to have been a happy one.

"In most of the insurance industry mergers to date, we've had holding companies being acquired by other holdings companies, and the individual life companies have been kept separate and distinct initially, and merged into another life company at some later point," observes Grey. "These mergers were dependent on cost savings to make them successful. That was not the rational behind our merger, which was done to expand market opportunities for both companies. In our case, we haven't been combined with AIG operationally, nor do we expect to."

SunAmerica is, however, coordinating the GIC marketing activity for the AIG Life companies. "The object is for both of us to grow the business and to be competitive in all the markets in which we choose to compete," Grey says.

With bigger and stronger competitors springing up in those markets as a result of the consolidation wave that's sweeping through the industry, SunAmerica's partnership with AIG should serve it in good stead. Look for more stable value players to adopt this strategy in the years ahead. ❖

As companies consolidate, an investment management firm may become affiliated with a company convicted of crimes that might appear to have no relevance to the management firm's retirement plan business. However, those crimes could result in the QPAM exemption becoming unavailable. Many firms have had to seek individual exemptions from the Department of Labor because of such problems.

These rules prohibit two basic types of transactions. First, they prohibit transactions with persons who have various relationships to the plan, including plan fiduciaries, other plan service providers, the plan sponsor, and affiliates of these persons — so-called "parties in interest." Second, they prohibit fiduciaries from engaging in self-dealing and conflicts of interest. Disregarding the prohibited transaction implications in a merger or consolidation can result in significant liabilities if prohibited transactions are later discovered. These include liabilities for any losses suffered by affected plans, liabilities for any benefits to the plan fiduciary and its affiliates as a result of the transaction, and possible excise taxes and civil penalties. The U.S. Department of Labor can grant class and individual exemptions from these restrictions, and a large number of exemptions have been sought and granted over the past 25 years since ERISA was enacted.

Some examples of the types of prohibited transaction issues that can arise are the following:

- An investment management firm managing an account for a plan, or a commingled fund in which the plan is an investor (such as an insurance company separate account or bank collective investment fund), may buy and sell fixed-income securities with an unaffiliated broker-dealer in principal transactions. The broker-dealer may provide other services to the plan and thus be a "party in interest" to that plan. While buying and selling securities with a party in interest is prohibited under ERISA, the transactions are covered by a class exemption for principal transactions, PTE 75-1. The transactions also may be covered by specific exemptions for particular types of collective pools — PTE 90-1 for insurance company separate accounts or PTE 91-38 for bank collective investment funds.

  However, if the investment manager and the broker-dealer become affiliates, these exemptions will no longer be available, since they do not apply if the party in interest is related to the manager. As a result, the investment manager may not be able to conduct principal trades through the now-affiliated broker-dealer.

- Investment managers often purchase securities in public offerings. If an affiliate of the investment manager is a member of the underwriting syndicate, the Department of Labor says that the purchase from the syndicate could be a prohibited transaction. PTE 75-1, the class exemption covering principal transactions mentioned above, also provides relief for purchases from an underwriting syndicate where a syndicate member is affiliated with the plan's investment manager. However, PTE 751 is not available if the affiliated syndicate member is a lead or co-"manager" of the syndicate.

  The effect of consolidation and regulatory change is particularly noticeable in this area. Investment managers are becoming affiliated with broker-dealers who engage in securities underwriting. This is the result of regulatory changes that allow securities affiliates of banks to engage in underwritings, as well as the result of mergers and acquisitions. At the same time, a smaller number of broker-dealers are involved in underwritings and those firms increasingly serve as syndicate manager. As a result, PTE 75-1 may not be available for number of underwritings. The effect is that investment opportunities can be foreclosed and the risk of a prohibited transaction is increased.

- Many insurance companies sell insurance contracts to plans under PTE 84-24. This is a class exemption from most of the prohibited transaction provisions to cover situations where the insurance company may be a fiduciary because it provides "investment advice" to the plan. However, PTE 84-24 is not available for a sale to a plan if the insurance company is affiliated with a plan trustee who has investment discretion. If such a relationship comes about through a merger or acquisition, PTE 84-24 may no longer be available. For future sales to the plan, the insurance company must either seek an individual exemption or restructure its operations to avoid potential prohibited transaction problems.

- A class exemption that many firms rely upon to avoid party in interest prohibited transactions is PTE 84-14, the "QPAM" ("qualified professional asset manager") exemption. It provides general relief for a plan portfolio managed by a bank, insurance company or registered investment adviser who meets certain requirements. One of these requirements is that the QPAM and certain affiliates and owners not have been convicted within the prior 10 years of certain types of felonies or other crimes.

As companies consolidate, an investment management firm may become affiliated with a company convicted of crimes that might appear to have no relevance to the management firm's retirement plan business. However, those crimes could result in the QPAM exemption becoming unavailable. Many firms have had to seek individual exemptions from the Department of Labor because of such problems.

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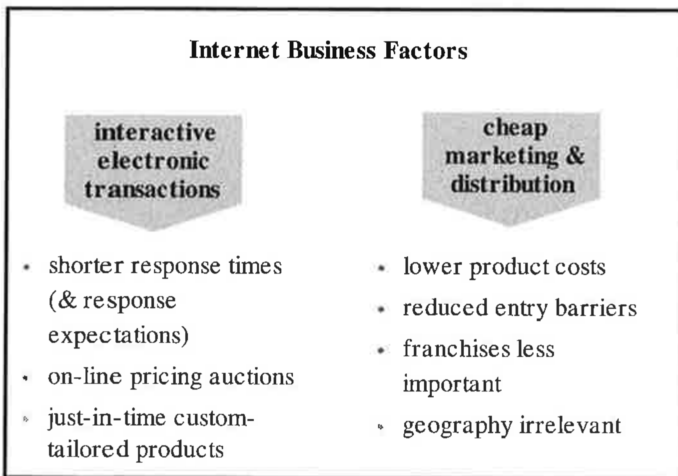
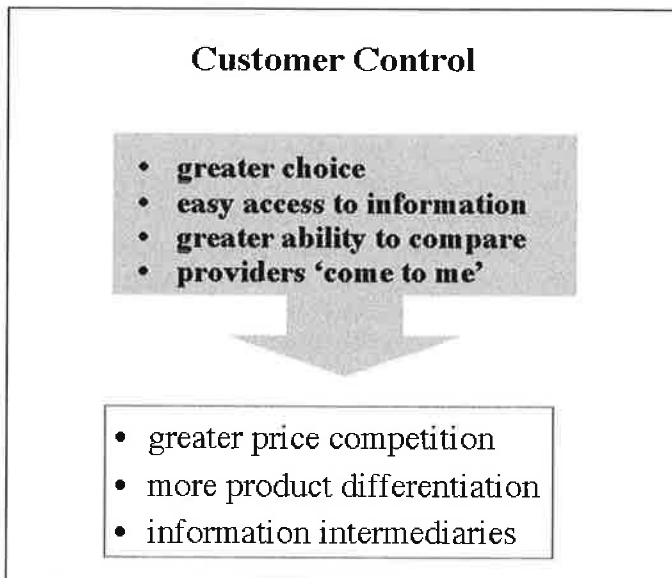
These ERISA problems could affect the potential benefits of a consolidation transaction. Companies considering such transactions, and their advisors, should take potential prohibited transactions into account in evaluating the consequences of consolidating their businesses, and whether any restructurings of business operations or Department of Labor exemptions may be necessary. These steps, taken early, should avoid potentially serious liability problems (and resulting business relation problems) in the future. ❖

Michael B. Richman, an associate at Reed Smith contributed to this article.





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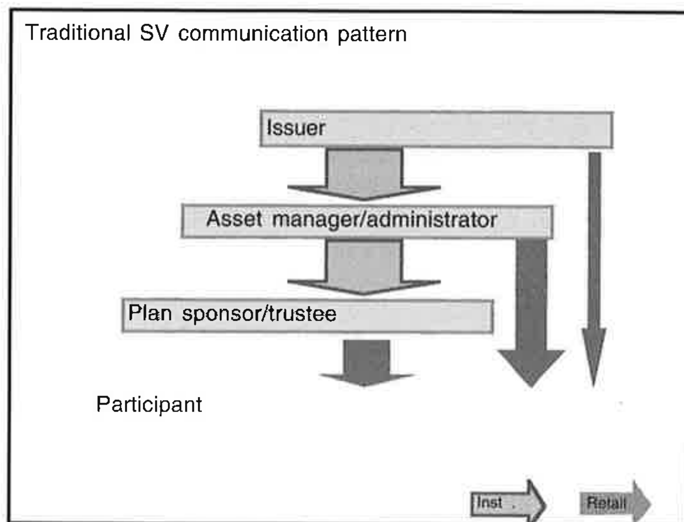
Internet Strategy: A Reduced Form Overview

The major new factors presented by e-commerce are hardly news, but few businesses have yet to face their full impact. Fast-paced electronic transactions allow provider-customer interactivity – which in turn changes the dynamics of pricing and purchasing. Already there are web auctions for many products, and web experts believe fixed prices will soon become a thing of the past for most goods and services. Custom-tailoring at the retail level will also become prevalent. Why not order a CD with just the tracks you want to hear - or get Lands' End to tailor those pants to your exact dimensions?

Moreover, the Internet makes it amazingly cheap to reach a world-wide customer base. A tiny firm can reach a large market without the expense of retail shops or salespeople, and the perception of a firm's quality is no longer dependent on its size. This means more entrants and thus more competition in many markets.



The ease of reaching customers gives the customer more information and greater access to products and services. For the first time providers literally come to the customer, who now can shop when and where he wants. This freedom is a form of empowerment, one which has shifted much of the shopping dynamic to the customer's direct control. As *Fortune* said recently, "The hunted has now become the hunter".

Knowledge is power. The web consumer will have the knowledge to find the best product value – the lowest cost for the value desired. With more information available, providers will find it easier to differentiate their products.

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Low retail distribution costs and the need to make sense out of all the information available on the net will change the role of intermediaries. Today's product wholesalers will likely evolve into tomorrow's information providers.

Stable Value Customer Communication

Understanding customers will be critical in the customer dominated world of e-commerce. The picture located on page 5 at the bottom right shows the traditional stable value customer 'food chain' from the investment contract issuer down to the participant level. Note that almost all communication travels down this chain, with only those who actually serve as administrators generally having any interaction with the final investor. The picture on the right, however, shows Landmark's view of the coming Internet communication pattern – with much more information sought by participants directly from providers at all levels.

We then decided to conduct a second search to see what a participant might find if he or she accessed SVIA provider member websites to look for stable value. This second search was done in January 1999. At that time there were 75 provider sites up and running. Given the institutional focus of the industry, we had expected to find more institutional web pages than retail. In fact, there were 53 retail locations and 51 institutional ones. However, the words "stable value" only appeared on 9 of the retail locations, compared to 18 of the institutional ones. Overall, the words "stable value" appeared on fewer than 1/3 of the sites, although many did have references to GIC, synthetic or investment contract.

On the assumption that individuals would be most likely to look for stable value on major mutual fund sites, we reviewed several of the largest . The table below summarizes the results for six firms, excluding those that also provide a wrap service. The phrase 'stable value' was found on only two of the sites, and one of the two referenced a money market fund. Even institutional investors won't find stable value on these firms' main web sites.

Even when the industry does succeed in reaching out to individual investors and participants, the survey uncovered a tendency to emphasize stable value's safety and not its returns. Typically the asset class is grouped with money market funds and rarely used as a substitute for bond funds.

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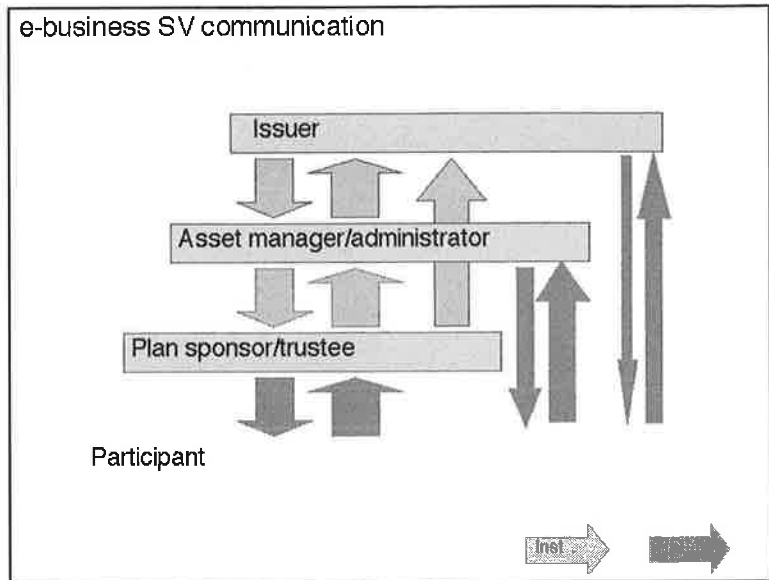
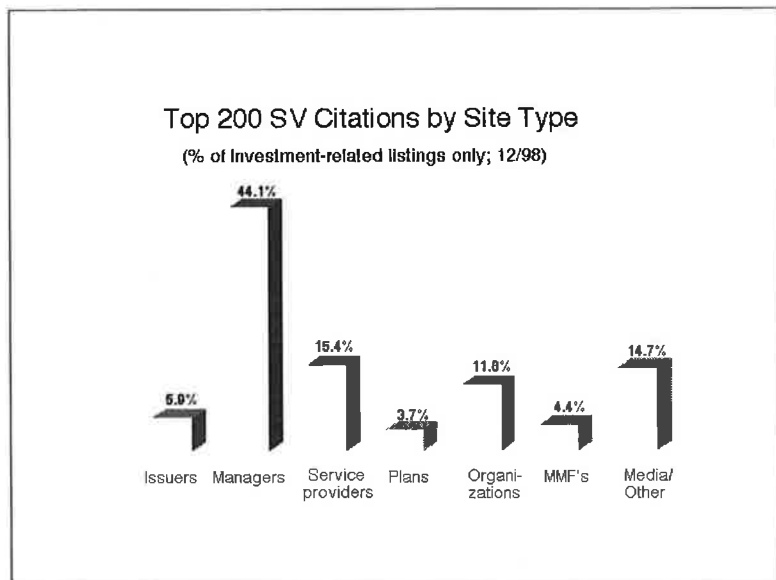
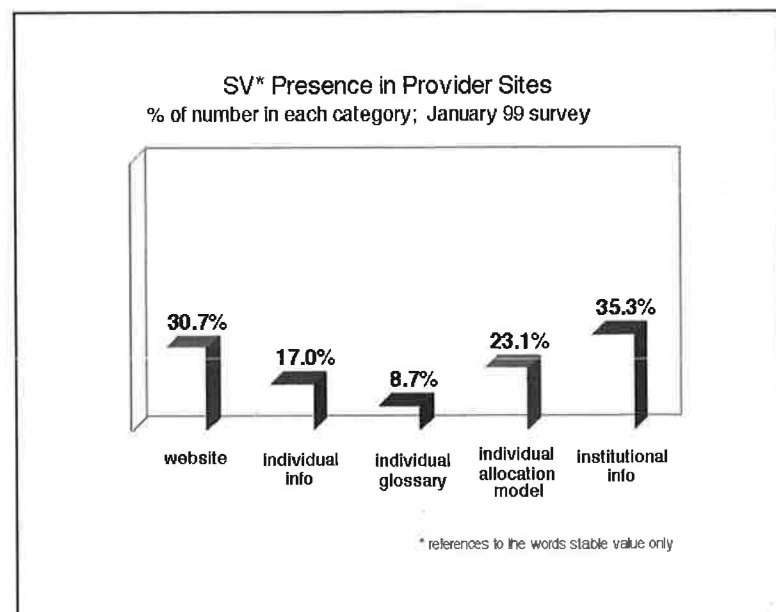






Overview of Key Mutual Fund Co. Sites

	SV mentioned	Individual investor info	SV in Individ info	investment glossary	SV in glossary	asset allocation model	SV in model	institutional investor info	SV in institutional
American Express	y	y	y	y				y	
Fidelity		y		y		y		y	
Putnam		y		y					
Scudder	y	y	y	y	y	y	y		
T. Rowe Price		y						y	
Vanguard		y		y		y		y	

"the Internet" continued from page 6

vocabulary that we carry over from institutional markets. Pages designed to channel visitors between retail and institutional sections of the site use buttons labeled "participant" on one hand and "'sponsor", "institutional investor" or "group customer" on the other. Are these meaningful to individual investors, even 401(k) ones?

Moreover, web definitions of stable value products (including GICs and synthetics) may not provide as much education to individuals as the industry would like. While there are excellent ones, the following also appear:

SV web definitions:

". .loans to an insurance company, paid back with interest. ."

". .assets that have book value accounting and book value liquidity. ."

"although they resemble bonds . . , these contracts cannot be sold and therefore their value is not market driven."

"an interest-bearing deposit . . ."

". . . a contract . ."

". . investments that are very stable . . ."

If individuals use the Internet as a basic resource for their investment education, the SV industry must see that they have access to appropriate web material. This will take an overall industry effort - a critical and vitally important effort. I've vowed to add participant-level information to my site, and I challenge other SVIA members to do the same.

A copy of the complete web survey and is available from Landmark Strategies by calling 781-860-7319 or sending an email to survey@lmstrategies.com. ❖

1999 National Forum Reminder

Be sure to register early for the 1999 National Forum: New Opportunities, New Frontiers. Register before August 27, 1999 to take advantage of the Early Bird rates. For more information, contact Scott Matirne by phone at 800-327-2270 or by email at scott@stablevalue.org or visit the SVIA website at www.stablevalue.org.

Monarch Hotel • Washington, DC

October 12-14, 1999

If you are interested in submitting an article for the next edition of *Stable Times*, please contact SVIA toll-free at 800-327-2270. You may also contact any member of the Editorial Board by phone or email for further information. (Editorial Board members are listed on page two of this issue.)

Stable Value Funds: A Vehicle for 401(k) Diversification

The certainty that stable value provides make them an excellent choice for anyone who wants to protect assets and optimize their retirement savings portfolio.

Gina Mitchell, President, Stable Value Investment Association

Creating retirement security for the public has challenged Washington policymakers, plan sponsors and service providers. The retirement savings community is tasked to increase coverage, savings, and provide the tools necessary to plan participants to enable them to save and plan for their retirement financial security. The community has met these challenges head on. However, the final test of the retirement savings community's work will come when the babyboomers' retire and the question that we are trying to met will be answered, "Can they afford to retire?"

State of Play for the Voluntary Retirement

According to recent Department of Labor numbers, employer-provided pensions now cover 65 million active employees or 63% of the workforce. This coverage is increasingly fueled by the growth of defined contribution plans. The Department of Labor's 1994 Annual Form 5500 Reports found a 9% increase in the number of active participants covered by defined contribution plans to 25.2 million, with a 13% rise in the number of 401(k) type plans to 175,000.

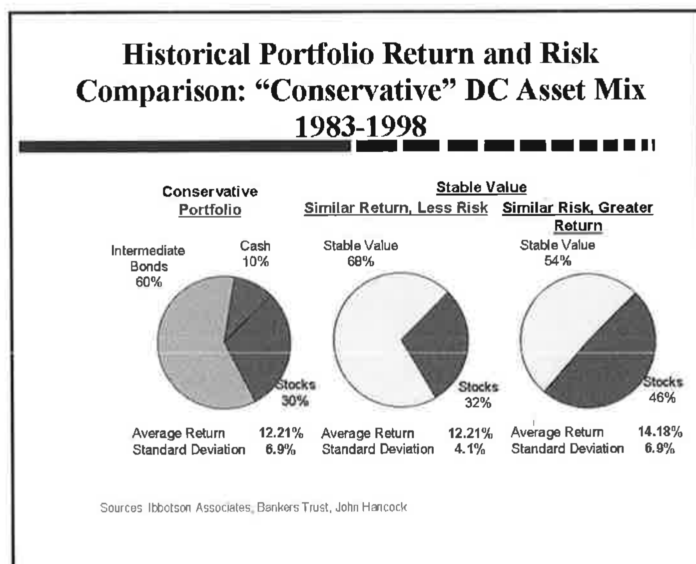
Importantly, the Department of Labor release demonstrates that the employer-provided pension system is working and working very well for those in the system. For 1994, benefit payments were $163.9 billion with the amount almost evenly split between defined benefit plan and defined contribution plan payments (respectively, $82.6 billion and $81.3 billion).

Although total contributions to all pension plans declined by 6% from $153.6 billion in 1993 to $144.4 billion in 1994, defined contribution plan contributions actually rose by 4% to $105.3 billion. Further, in 1994 total contributions in defined contribution plans made by plan participants were almost equal to employer matching contributions.

With the report's preponderance of information, it is easy to gloss over one surprising fact: "plans with over 100 or more participants' aggregate rate of return in 1994 was 2.9%." This is the lowest rate of return over the 10-year life of the statistic. The 2.9% return was well below the report's 10.3% average rate of return for the ten-year period, 1985-94. When 401(k) returns are separated out, the total aggregate rate of return for defined contribution plans was shown as 3.8% for 1994 and 10% for the ten-year period.

Preparing Individuals for Market Realities

1994's investment/return experience may or may not reoccur. However, it illustrates that our challenge is not just encouraging participation and increasing contribution rates, its teaching and preparing individuals for the realities of the financial market that may include less than double digit rates of returns and even the possibility of negative returns in some asset classes. For plan sponsors and participants, this may well mean rediscovering the stable value funds that are currently offered in two-thirds of all defined contribution plans and comprise roughly $250 billion in assets.



Stable value funds, which invest in conservative fixed income investments, offer investors certainty by providing predictable returns that average one and a half to two percentage points above money market funds. Returns for stable value funds currently average six and a half percent, which is comparable to intermediate corporate bond funds minus the market risk. Since they do not have market risk, stable value funds preserve both investment principal and accumulated interest earnings.

The certainty that stable value provides make them an excellent choice for anyone who wants to protect assets

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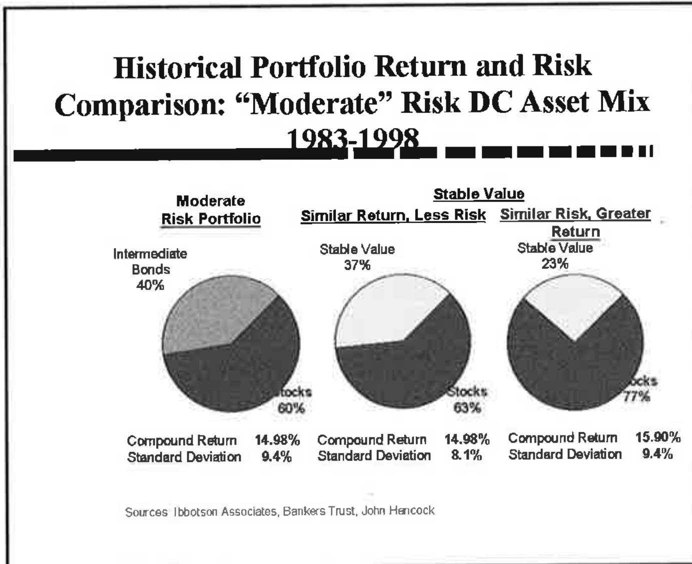
"401(k) Diversification" continued from page 8

and optimize their retirement savings portfolio. Stable value funds permit an individual to direct more money into riskier and higher earning investments such as equities, and achieve higher longer-term returns without increasing risk. Conversely, stable value funds can be used to reduce risk without sacrificing return. The pie charts (on pages 8 and 9) demonstrate how stable value can be used by an individual to optimize risk and return to achieve his or her investment goals.



Diversification, A Necessity

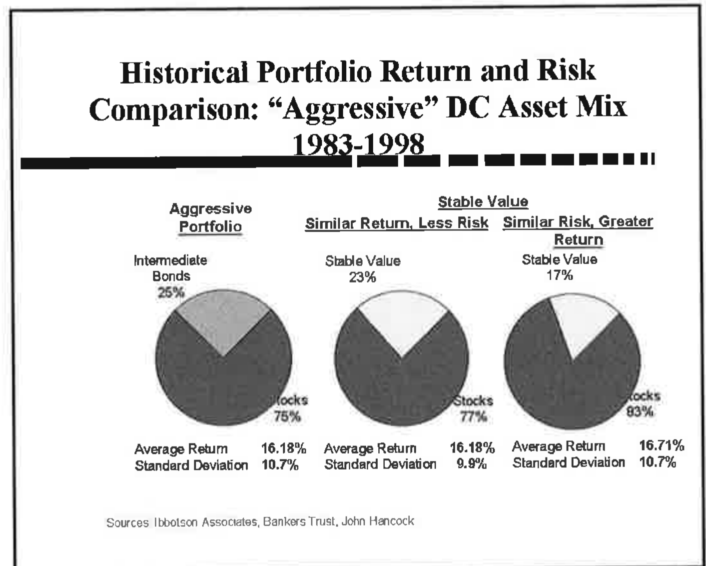
It is stable value's ability to be a vehicle for diversification that will spur its rediscovery. The EBRI/ICI Participant-Directed Retirement Plan Data Collection Project, which provides 1996 information on 6.6 million active participants with $245 billion in assets shows how. The data demonstrates not only the role stable value can play in retirement savings but how plan participants have applied the concept of diversification across broad age spectrums.

Market realities and a retirement system that has shifted to more individual self-reliance will continue to test the retirement savings community's ability to prepare individuals to plan their retirement income needs. 401(k) participants' understanding and use of the concept of diversification is fundamental to ensuring individuals have the ability to adequately plan and save to meet their retirement income needs. Asset allocation models may become the new vehicles for giving 401(k) participants the information and the tools to make these important choices that will affect participants' income at retirement.

Giving Participants Information to Make Appropriate Choices

In May of 1996, the Department of Labor provided guidance that distinguished information from advice in Interpretive Bulletin 96-1. Briefly, the bulletin says the use of asset allocation models will not be considered recommendations or advice if the models:

- Are based on generally accepted investment theories that take into account the historic returns of different asset class over time.
- Provide all material facts and assumptions used in the model.
- Provide a statement that other alternatives having similar risk and return characteristics are available and where information can be obtained if any specific investment alternative available under the plan is identified.
- Provide a statement that in using the model, participants should consider their total financial resources including assets outside of the 401(k) plan.



Challenges for Stable Value to Be Part of Participants' Package

Stable value looks like a natural for asset allocation models. However, the very characteristic that makes stable value funds advantageous and distinct from other fixed income options such as money market funds and bond funds (the certainty of principal and accumulated earnings or benefit responsiveness) may serve as a hurdle for some to incorporating stable value funds into models.

"401(k) Diversification" continued on page 10

"401(k) Diversification" continued from page 9

Asset Allocation, By Age

	20s	30s	40s	50s	60s	All
Other**	1.1	1.2	1.1	1	0.9	1
Money Funds	5.2	4.8	5.2	5.3	6.1	5.4
Bond Funds	5.8	5.6	6	7	9.2	6.8
Stable Value Funds*	7.9	9.4	12.6	17	27.7	15.9
Company Stock	16.7	19.6	21.1	19.5	15	19.1
Equity Funds	55.1	51.2	46.2	42.5	33.9	44

Source: Tabulations from EBRI/ICI Participant-Directed Retirement Plan Data Collection Project

* Combines GICs with stable value funds.

**Combines Other with unknown.

Hueler Company reports that stable value can offer participants 1.5%-2% higher annualized return than money market funds and over a five year period ending 12/31/98, have comparable returns of an intermediate bond fund with 45 times less volatility. On a cost basis 401(k) stable value funds provide a competitive, lower cost option, with costs averaging between 10 to 30 basis points depending on the specific type of stable value fund.

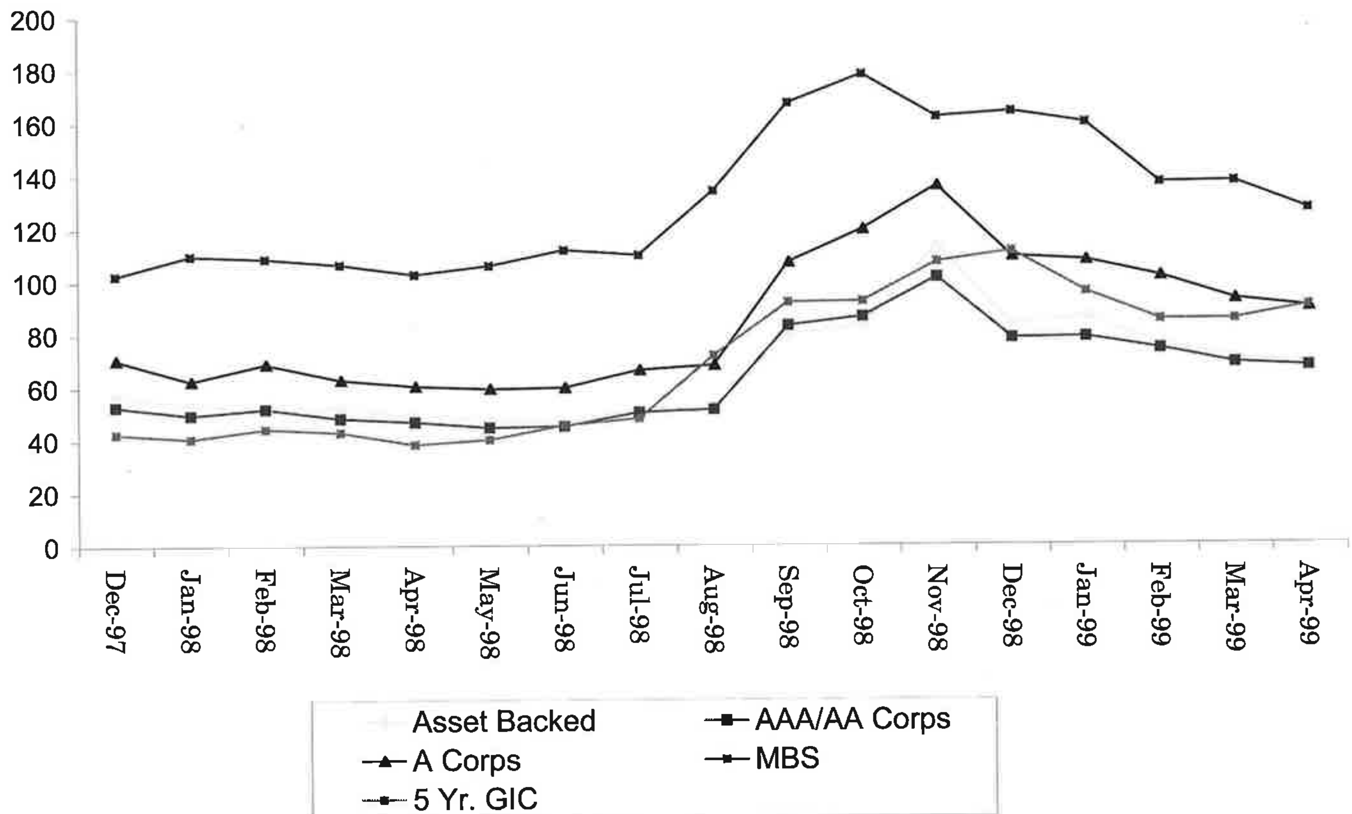
Returns as of 12/31/98	*Hueler Stable Value Index*	*Lipper Money Market Average*	*Lehman Int. Gov/Corp*	*S&P 500 Index*
1 Year Return	6.41%	4.85%	8.44%	28.65%
3 Year Return	6.40%	4.85%	6.77%	28.25%
5 Year Return	6.38%	4.71%	6.60%	24.08%
5 Year Standard Deviation	0.14%	0.63%	6.33%	14.20%

Yet, as data from Hueler Company illustrates, stable value's features make it too important an asset class to simply leave out. The challenge for plan sponsors, stable value issuers, wrappers and managers, is getting the unique characteristics of stable value and acceptance of stable value as an asset class distinct from bond and money market funds widely recognized in asset allocation models and other 401(k) informational material. ❖

Tracking Stable Value Yield Spreads

Karl Tourville, Galliard Capital Management

Yield spreads on fixed income instruments narrowed versus U.S. Treasuries during the first part of the year as continued strength in the U.S. economy made investors more comfortable assuming credit risk. In fact, with the tightening of spreads in recent months, the flight to quality seen during last fall's global financial crisis has largely been reversed. Consequently, spreads are only slightly higher than experienced during the historic lows achieved early last summer. Meanwhile, Interest rates on Treasuries have continued to climb as the Federal Reserve has shifted monetary policy to a tightening bias. Yields on intermediate maturity Treasuries have increased over one full percent year-to-date through the end of May. GIC's continue to represent good value relative to comparable quality corporate bonds with yield pickups of approximately 20 basis points for five-year maturities. ❖



Where on the World Wide Web is Stable Value?

Nell Hennessy, Senior Vice President, ASA

Stable value needs to join the Internet revolution or it will suffer the consequences: declining market share. Luckily, as the saying goes, "If you build it, they will come."

As employers and employees increasingly turn to the Internet for information about their 401(k) assets, they can hardly avoid advice on investing in stocks and they are hard pressed to find information on investing in stable value. Stable value providers need to correct this situation by providing Internet information and tools to educate participants about stable value investments and the role stable value can play in a balanced portfolio.

Why is 401(k) information on the Internet?
The answer is primarily because the major 401(k) vendors provide Internet access to individual 401(k) accounts and investment options. These sites also provide education for participants about how to invest, ranging from the basics ("what is a stock") to interactive calculators and asset allocation models. Employers and 401(k) vendors are using Internet-based communications to:

- Enhance communications by providing employees with multiple paths to information, allowing different users to find their own way at their own pace.
- Provide 24-hour service, seven days a week, 365 days a year.
- Facilitate employee self-reliance, which allows for more efficient use of service centers and human resources personnel, an important consideration as companies continue to downsize their administrative staffs.
- Improve service to dispersed users.
- Foster a common corporate culture.
- Allow quick dissemination of information and updating of employee information while reducing costs.
- Comply with most federal notice and disclosure requirements on a more efficient and cost-effective basis.
- Answer participants' questions about various life events that may impact their employee benefits.

Stable value needs to join the Internet revolution or it will suffer the consequences: declining market share. Luckily, as the saying goes, "If you build it, they will come."

Investor Education
Probably the most important opportunity is investor education. Employers have shifted investment responsibility to employees, in part to minimize potential fiduciary exposure for individual investment choices. However, to minimize employer liability, employers must provide enough information to their employees for employees to make informed investment choices. Employers don't want to be in the business of giving investment advice. At the same time, financial product vendors don't want to become ERISA fiduciaries as a result of the participant information they provide.

Historically, employees have had very little risk tolerance, which has favored stable value funds. Even with education campaigns on investment risks and returns, and the stock market's continuing upward climb, participants need to be reminded about the risks inherent in both stock and bond funds. This is particularly true for those nearing retirement or others with specific near-term financial needs.

Models
Asset allocation models are an easy way to make this point. They allow participants to model what they think (or fear) will happen in the future. In most cases, human resource professionals have neither the time nor the training to go through these what-if scenarios with participants, and participants do not want to discuss some of the scenarios they want to model, such as the impact of a job change or potential disabilities.

The Department of Labor has outlined a safe harbor for asset allocation models that permits their use if the model is based on generally accepted investments theories and historic returns of different asset classes. All assumptions must accompany the model. The model can even identify your specific stable value option if a statement is included about similar alternatives in the plan.

Plugging In and Logging On
Employers are looking for modules to plug into their Internet and Intranet sites. Employers and their employees need to begin to hear about stable value. Stable value funds need to increase their Internet visibility by providing easy access to this material.

Ideas for Stable Value Products
Interactive materials that are particularly popular and would be useful for stable value vendors to provide include:

- Questionnaires designed to identify risk tolerance and investment time horizons.
- Calculators or worksheets allowing participants to model anticipated retirement income needs, taking into account other assets and pension payments that will be available in retirement.
- Software that participants can download to model their retirement income needs off-line.

Interactive materials can be used to estimate future retirement income needs and assess the impact of

"World Wide Web" continued on page 13

"World Wide Web" continued from page 12

different asset allocations. For stable value vendors, a winning strategy would be to focus on interactive materials that assess risk tolerance and emphasize stable value's role in the fixed income portion of the participant's asset allocations at various times in their working and retirement lives.

Generating Use

Having created the Internet tools, stable value providers need to publicize them and make them accessible to employers and to participants on the Web. SVIA has some excellent information on its site (www.stablevalue.org). Link to that site if you want a quick and easy way to get an Internet presence. On the SVIA listing of industry links, give SVIA a link to a page on your site that deals specifically with stable value rather than the generic front page of your corporate site. SVIA's page comes up most often on the first page of a net search if a participant plugs in "stable value"; almost none of its members have pages that show up in that search. Establish different pages for employers (who must be convinced to include your fund in their plan) and for their participants (who must be educated about the role that stable value provides in their future retirement security once the fund is in the plan).

Parting Words of Advice for Stable Value Funds

The biggest mistake is to wait until your stable value site is "done." The beauty of the Internet is the ease with which it can be changed. Put something up, get feedback from your customers and other visitors. Put up new material that keeps people coming back. Jettison things that don't work. As long as you plan for change, even if you don't know exactly how you are going to change, your site can be a valuable marketing tool for your stable value products and a valuable customer service for employers and participants. ❖

Electronic Commerce in the Traditional GIC Business

John Milberg, Senior Vice President, Pacific Life Insurance Company

Are traditional GIC buyers and sellers embracing electronic commerce? The answer to this question was sought in a recent confidential survey conducted by the SVIA. The survey was sent to 17 stable value issuers and to 22 stable value buyers. Responses came from 90% of the recipients. The survey answers provide insights into the current transactions performed on the web, the motivations driving web growth, and respondents' future plans for increased web use.

Today's Internet use is concentrated in the transmission of data via email. 93% of the issuers and 83% of the buyers currently transmit and accept bid specifications via the web. 53% of the GIC issuers and 67% of the buyers use the Internet to communicate contract rates and terms. Fund accounting statements are transmitted by 40% of the issuers, whereas 25% of the buyers receive fund accounting statements over the net. In addition, once a sale has been made, one-fifth of the issuers admit to transmitting contract documents via the Internet and one-half of the buyers accept them electronically. Other uses mentioned include the communication of bid results, contract language revisions, and daily rates.

What factors have lead to the wide spread adoption of e-commerce? Both the issuers and the buyers agreed that the web's efficiency was a major factor in using the web. In addition they mentioned the ease of web implementation. Where issuers and buyers diverge is in being pressed to provide web functionality by their customers. 87% of the issuers say their customers pushed them to web use. In contrast, none of the buyers mentioned customer preferences as a factor. Somewhat surprisingly, competitive pressure was not a significant factor for either buyers or sellers.

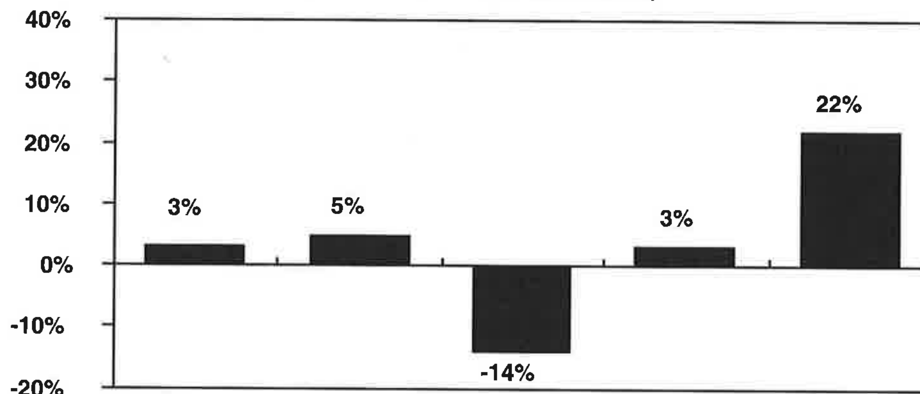
As for the future, both issuers and buyers expect their use of Internet technology to increase, and those who are not using it today, will probably do so in the future. For the GIC issuers, eleven (92%) of the 12 current users expect their business use of the Internet to increase. For the GIC buyers, twelve (80%) of the 15 current users expect their business use of the Internet to increase. Of the eight respondents (both issuers and buyers) currently indicating no web use, three expect to transact web business within 12 months.

In summary, today's Internet use is concentrated in the transmission of data via email. The future will no doubt bring on-line shopping and buying into the picture. Both issuers and buyers expect their use of Internet technology to increase in the near future, and those who are not using it today, will probably do so soon. ❖

SVIA-LIMRA Survey Finds Largest Increase in Five Years for Stable Value Sales

The SVIA-LIMRA Guaranteed/Stable Value Product Sales Survey for 1998 found sales had risen 42%, the largest increase in five years, to over $75 billion. Although stable value sales increased dramatically in 1998, assets increased more modestly by 13% to $270 billion. Further, non-qualified stable value product sales increased by 127%, while qualified stable value sales grew by 11%. The survey is based on the participation of 43 companies whose sales represent over 90% of the stable products sold last year. ❖

Total Stable Value Product Sales+ (Percent Change 1994-1998)



† *Sales refer to deposits to new contracts*
* *Excludes companies that manage assets only*
Growth rates are based on companies with two years of comparable data.

Total Sales and Assets By Market**

	Sales (000,000)			Assets (000,000)	
	Year-end 1998	Percent change	Average size contract	Year-end 1998	Percent change
Qualified	$40,386.6	11%	$4,369,289	$208,158.1	3%
Nonqualified	31,028.7	127	37,870,867	43,565.1	65
Total**	75,129.0	42	7,564,907	270,332.6	13
Number of companies	*41*	*41*	*34*	*43*	*43*

** *Includes companies unable to break out products separately and Bank Investment Contract assets*

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Stable Value COLI/BOLI Products

Jon Fraade, AIG Financial Products; Lori Guadagno and Joe McKinnon, AIG Life

For many years, banks and corporations have purchased life insurance in order to provide the funding needed to meet the non-tax qualified benefit programs that they provide to their employees. Generally speaking, this insurance is referred to as Corporate-Owned Life Insurance (COLI) AND Bank-Owned Life Insurance (BOLI). In recent years, a new product has been developed by a number of the leading BOLI providers – a stable value BOLI policy. The purpose of this article is to provide the reader with the general rationale for the use of a COLI/BOLI policy, followed by a description of the new stable value policy.

Most corporations provide a variety of employee benefit programs, only a limited number of which are "qualified" by the Internal Revenue Service. The best –known qualified benefit is a company's pension plan, which allows for the tax-free investment of trust assets that are for the benefit of the employees. Some of the more common non-qualified benefits are retiree medical benefits, supplemental retirement benefits for higher paid employees, and pre-retirement survivor benefit plans. In these cases, the investment income that is generated on money that is set aside to fund these benefits is generally taxable and the cost of these benefits can only be deducted when they are actually paid to employees.

As a result, there are two significant incremental costs to the corporation related to a non-qualified plan; first, that investment income is taxed and second, that the income is taxed on a current basis with any offsetting deduction related to the benefit often not allowed for may years.

In light of the unattractive tax attributes related to non-qualified benefit programs, many corporations use COLI (or BOLI in the case of banks) as an investment product that helps them to meet their future liabilities. With a COLI policy, the corporation purchases life insurance on its employees. A corporation may purchase life insurance on its employees if insurable interest exists at the time of the purchase; ongoing insurable interest is not required. For insurable interest to exist at the time of purchase, the benefits purchased must be reasonable in relation to the liabilities related to the benefits for the employees and, in some states, consent to purchase life insurance must be obtained from the insured employees. As part of this policy, the corporation makes one or more premium payments (deposits can range from $1 million to $100 million or more) to the insurance policy. As a result, the policy has both a cash value (initial deposit, plus or minus investment performance, less insurance charges) and death benefit value. Because the deposit is within an insurance policy, it grows on a tax-deferred basis until such time that the insured withdraws money from the policy. In addition, death benefits are paid on a tax-free basis. Therefore, the investment has the potential to appreciate on an effectively tax-free basis, provided that the owner is willing to defer a withdrawal under the policy and to wait for the death of the insured. The tax deferred (and potentially tax-free) appreciation of this investment significantly offsets the upfront costs of a COLI policy – most of which relate to various state and federal surcharges. Given that it may be a long time until the employees covered by the policy die, it is possible to "borrow" against the policy in order to obtain interim liquidity, which reduces the future tax deferred growth in the investment balance but, at the same time preserves the owner's potential for tax-free appreciation.

Why Stable Value?

The development of the stable value BOLI market mirrors, in part, the development of the synthetic GIC market. First of all, the premium payments into these policies are significant in size and are, by their nature, long-term. In order to get the maximum benefit, it is not unusual for the holding period to be 20-40 years long, or even indefinitely. Because these programs represent a small portion of a corporation's capital but produce an excellent return over the long-term, corporate financial officers view these programs as indefinite investments without the need for short-term liquidity. Initially, banks used insurance products backed by the insurance company's General Account, which by its nature provides a stable return. This stable return is especially important for banks, as the mark-to-market on a BOLI policy flows through a bank's income statement. Given the leveraged nature of a bank, wide swings in the value of a BOLI policy, and the resulting impact on both capital and net income are generally unacceptable.

At the same time that banks demanded a stable value product, they also expressed a view that has become very common in the qualified stable value market: the desire for increased asset diversification and for the potentially higher returns that arise from the use of active bond management. The result of these demands has been the development of a variable BOLI product where underlying assets are held in a separate account of the insurance company but the mark-to-market volatility is dampened through the use of a stable value wrapper. The stable value wrapper provides for accrual of the portfolio value and a crediting rate, which is based on the current market yield and the amortization of investment gains or losses over a predetermined period. The stable value BOLI product is usually one of several investment options that may be offered in a variable BOLI policy.

"COLI/BOLI" continued on page 16

New at SVIA

Performance Measurement Task Force Wants You!

SVIA's Performance Measurement Task Force is gearing up for Phase II: the dialogue and development of next steps on the Task Force's recommendations that were released in February of this year. Phase II will be led by IBM's Dan Libby and PRIMCO's Paul Donahue. Members interested in working on this important issue should contact SVIA's Washington Office or the new Task Force co-chairs, Dan and Paul.

Register Now for the Annual Forum

On October 12-14th the SVIA Annual Forum on *New Opportunities, New Frontiers* will be held at the Monarch Hotel in Washington, D.C. The two and a half-day Forum features:

- *Tom Gardner*, author and online financial hero. He is half of the Gardner Brothers team that created The Motley Fool – the wildly successful Web site consistently rated one of the best sites online. It is the most frequently consulted financial forum in the online world, with over 750,000 monthly readers.
- *Dallas Salisbury*, the leading authority on benefit trends and public policy issues. Dallas is the President & CEO of the Employee Benefit Research Institute; a Washington-based think tank dedicated to providing the latest objective and unbiased information on key employee benefit issues.
- *Mark Goldstein*, an internationally recognized authority in the field of aging and its implications for the workforce and marketplace. As the North American Training Director for Age Wave Communications, Corp., he assists companies and associations develop marketing programs that increase and retain consumers and members by understanding the profound demographic changes that are occurring.

Check www.stablevalue.org for a complete program description and updates on the Forum and registration details. Remember to register before August 27 to qualify for SVIA early bird registration savings!

What do Y2K and SVIA have in common?

The answer is simple, a big event—SVIA's National Annual Forum scheduled for October 10-14 in year 2000. Please hold the date for SVIA's National Forum, which will be held at the Monarch Hotel in Washington, D.C.

Where is SVIA?

SVIA has relocated to:

1215 17th Street NW
Washington, DC 20036
www.stablevalue.org

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Main: 202 467 2760
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Scott Matirne
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Phone: 202 467 8013
Email:scott@stablevalue.org

Gina Mitchell
President
Phone: 202 467 8051
Email:gina@stablevalue.org

MEMBERS ONLY

While on the Internet, remember to try out SVIA's new MEMBERS ONLY section. If you have forgotten your user identification or password, call Scott to get immediate access.

"COLI/BOLI" continued from page 15

Accounting Issues

While similar in some respects to a synthetic GIC, the accounting treatment for a stable value BOLI product relies primarily on Financial Accounting Standards Board Technical Bulletin 85-4, *Accounting for Purchases of Life Insurance*. AICPA Statement of Position 94-4, does not apply because it is limited to stable value investments that are owned by defined contribution and health and welfare plans. FAS 85-4 states that the investment should be valued as "the amount that could be realized under the insurance contract as of the date of the statement of financial position." Therefore, as of each reporting date, the owner needs to have full access, at "book" value, to the assets in the policy. This is fundamentally different than a stable value investment in a qualified plan because access is held centrally, usually by the insured's Treasurer, an individual who is assumed to be financially astute.

From a provider's perspective, the risk related to accessing the underlying portfolio at par, is considerable. The primary basis upon which a provider can get comfortable providing this put is a view that the liquidation of the policy will give rise to a tax liability that the owner might not have alternatively incurred. In addition, the provider may add a number of other provisions to the policy to reduce the risk of this put.

Since BOLI needs to be structured as an insurance product in order to obtain the preferential tax treatment, most of the stable value wrap providers have been affiliated with the insurance company that is providing the policy. Finally, because of the nuances of this developing product, the initial cost of making the investment, and the long-term nature of this investment, it is very important to make sure that the accounting for this product be fully vetted by the owner and its auditors. ❖