SVIA STABLE TIMES

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Are GICs Efficient Assets to Include in Stable Value Funds?

By K. Daniel Libby
The IBM Retirement Fund

"Show me the risks..."

Stable value funds, in many ways, are the simplest of investment vehicles. Participants seem to understand these funds very well. Analogous to passbook savings accounts, they provide the return of bond funds with the volatility of money markets. This seemingly incongruous set of facts gives these funds risk / return profiles that appear too good to be true.

Indeed, there are many types of risk involved in managing a stable value fund.

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DC Plan Brokerage Accounts: Renewed Challenge for Stable Value Providers

By Randy Myers

The growing popularity of self-directed brokerage accounts in defined contribution plans is reviving an old challenge for the stable value industry: how to prevent plan participants from arbitraging their stable value funds during periods of rapidly rising interest rates.

For many years, the only such arbitrage threat came from money market funds and other very short duration bond funds. When interest rates spiked, participants in 401(k)s and other defined contribution plans had an incentive to swap money out of their medium-duration stable value funds and into cash equivalents. Had they done so, they could have forced their stable value funds to make benefit payments when the market value of the fund was less than the book value. The economic loss associated with higher rates would be transferred to the remaining participants in the stable value funds or the issuers.

To prevent this risk-free arbitrage, plan sponsors have long imposed an "equity wash" requirement on plan participants who want to switch out of a stable value fund and into a so-called "competing fund." Competing funds are usually defined to include money market funds and other fixed-income funds with very short duration. Equity wash rules say that money cannot be transferred directly from a stable value fund to a competing fund; instead, they must be transferred to an equity fund first and held there for a minimum period of time, usually 90 days. Therefore, the participant must

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EDITOR'S CORNER: *Think Outside the Box*

By Janet Jasin Quarberg, Hueler Companies

As a "first time" Editor of the Stable Times Newsletter, I decided to look back through the few years of newsletters to get a feel for how I should write the Editors Corner. Rarely do I take time to reflect and look back, but in doing so I realized how much has changed and how much this industry has progressed. This of course has not been without surviving some trying times, but as they say, "No Pain, No Gain."

Over the past five years our market has gone through a frustrating period as we helplessly watched cash flow flood to equities. It was a difficult time, but it gave us time to reflect, regroup and "think outside the box." As a result, I think we as an industry are better because of it. We have created a host of new products, successfully entered several new markets, banded together to create a very capable Association, which continues to be a united voice delivering the message of stable value to vast and varied groups of people. Stable value has gained significant strength and is well positioned to face the challenges ahead and make great strides in the coming years.

In this issue we have several articles that highlight the sentiment described above. Allen Fen, from Fen Associates and Gina Mitchell from SVIA, review SVIA committee infrastructure. Many members contribute a significant amount of time, resources, and motivation, all of which are critical for stable value's continued progress as a recognized and respected asset class. This article highlights each committee, its members and the key responsibilities of each group. In future Stable Times issues, we will be asking a different committee each quarter to highlight their initiatives giving membership a more detailed understanding of the Association activities underway.

One of the challenges on the forefront is "Asset Allocation Models", which without question will impact stable value either positively or negatively in the years to come. Sean Hanna from 401kWire contributes an interesting article covering the key players in the market, a historical overview of the business and a status update. Victor Gallo, from Jackson National sets the stage and explains where stable value fits in and why models are so important to our market.

Randy Meyers joins us once again with an article that reviews the growth of the Brokerage Accounts within DC plans. Randy interviewed plan sponsors, discretionary managers and issuers and gives a comprehensive overview of the issues and attitudes.

Greg McGreevey contributes the first article in a series of three, which highlights the results from a survey conducted at the GICs '99 conference held in Phoenix in April. The first segment looks at conference attendee's outlook for growth in Stable Value and other related markets over the next 5 years. In future issues of Stable Times he will present his findings on Underwriting Issues and Investment Allocation & Analysis.

Also in this addition, Jeff Norris from MetLife provides a thought-provoking article that pushes the envelope. He explores the idea of adding equities to stable value portfolios, which may require some of us to "think outside the box." In the past this concept has made me a bit uncomfortable, but Jeff presents some compelling arguments that are worth consideration. We'd like to know your thoughts in the next issue. Agree? or Disagree? Contribute a counterpoint article!

Last but not least, Dan Libby from IBM contributes an article that explores and evaluates the relative value of the traditional GIC sector of this market. In this ever changing marketplace, where there are now a myriad of products to choose from, its somewhat comforting to find that traditional GICs continue to offer solid relative value as they are the foundation from which this business was built.

Well, read on, push ahead, and continue to "think outside the box!"

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Furthermore, they will tell you that there is no "free lunch" in these vehicles; the price for this risk reduction must be tallied so as to include both the explicit as well as the implicit costs, i.e., participant transfer restrictions.

However, the unfortunate truth is that while these funds may be simple for participants to understand there is little true understanding of how these funds work outside of the stable value community. More pointedly, there is little understanding of the risks undertaken in these funds. In fact, the appearance of the absence of risk may only exacerbate the problem.

Indeed, there are many types of risk involved in managing a stable value fund. These include liquidity risk, credit risk, duration risk, sector allocation risk, active / passive risk as well as the risk of non-competitive returns. But these are much the same risks that exist in all fixed income portfolio management. So while the benefit responsive insurance is responsible for "simplifying" these funds for participants, it is also responsible for obfuscating the risks underlying these funds to professionals and participants alike.

The adoption of a performance measurement standard for stable value funds will alleviate this issue. In traditional portfolio investment management, AIMR-compliant Performance Presentation Standards (PPS) are used to quantify these same risks. For example, a manager's return stream can be evaluated many different ways to detect a manager's expected alpha as well as any style bias. Examples of style bias would include holding excess liquidity, lower credit-quality assets, duration and sector bets, just as we mentioned above as being risks currently hidden in the returns of stable value funds.

Yet this is only half of the problem. Even with the proper measurement of a GIC portfolio's performance, the fundamental questions still remain. "Are the GIC holdings being utilized efficiently?" "Do GICs represent a competitive asset to traditional fixed income securities?" In other words, how will we benchmark the use of GICs in a stable value portfolio? Drawing informed conclusions about the risks inherent in a portfolio based on a stream of performance numbers requires a baseline for comparison.

Currently, there does not exist a GIC sector index as a component of a Lehman-stlye family of indices showing periodic total rates of return; such as exists for other fixed income asset classes. If such an index were available, these questions, and many like it, could be addressed directly.

In lieu of that, we can try to answer these questions by creating a surrogate GIC index showing historical total rates of return.

A Surrogate GIC Index

First, a caveat is in order. Anytime there is an attempt to recreate history; one must understand the limits of the data they are working with. The construction used here is meant to quantify, generally, the performance and risk characteristics of GICs historically. Data was gathered from multiple data sources, namely Bankers Trust and T Rowe Price; and although every attempt was made to ensure consistency, in the end there is no substitute for actual performance data from a single source. The author would like to thank John Hancock's Wayne Gates and Klaus Shigley, respectively, for assisting with the data used for this analysis and for providing their comments to the analysis. However, any errors or omissions in the use of this data or the conclusions drawn from it, unfortunately, are my own.

While the GIC marketplace does not have readily available total return series', it does have a fairly lengthy history of GIC spreads at various maturity points. We begin by accumulating GIC rates for 2 year, 3 year and 5 year maturities going back to January 1983. Again, some care must be taken to maintain consistency due to various quote conventions for different data streams from different providers. Nevertheless, recognizing that if we assume the initial economic value of a GIC is par then, given the yield, coupon, maturity and change in yield, it is possible to determine its total rate of return.

In this way we can use the GIC offering yield each month to compute the total rate of return of a constant holding in a given maturity of GIC assets. For example, the time series of 2-year GIC rates can easily be converted into a total rate of return time series for an investment strategy of continually selling last month's on-the-run 2-year GIC and purchasing this month's on-the-run 2-year GIC asset. Note that here we are assuming that the offering yield can also be used for the bid pricing at month-end. But, similarly, traditional fixed income indices are passive, buy-and-hold, portfolios priced consistently at one side of the market to minimize transaction costs as well.

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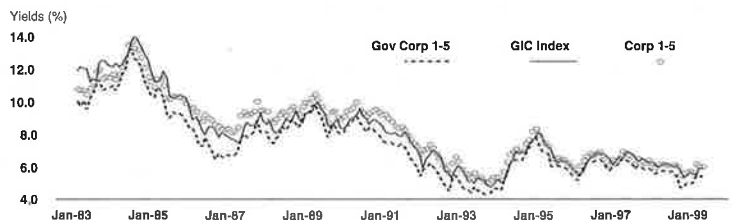
As we compute the total return time series for 2-year GICs we can also compute the duration of this simple portfolio. Likewise we can calculate the same information for the 3-year and 5-year time series' as well. Armed with these three data streams across the maturity spectrum we are ready to construct portfolios of GICs as linear combinations of these three investment strategies to target any desired duration between approximately 2 and 5 years. Duration-weighted GIC portfolio yields are available as well. The purpose of modeling a GIC portfolio by using three maturity points is to try and capture some of the yield curve exposure that an actual portfolio would have.

The final step is to choose constant weightings of the three maturities of GICs to create a GIC portfolio to compare against a public fixed income index. As for the choice of public index, it would appear to make sense to evaluate two investment-grade indices against this surrogate GIC index: the Salomon Brothers 1 to 5 Year Government / Corporate index and the Salomon Brothers 1 to 5 Year Corporate index. These indices will straddle the quality rating of a portfolio of GICs. Furthermore, the absence of option-laden mortgage holdings in these public indices also would be appropriate for evaluating a traditional GIC portfolio.

Several techniques were explored to calibrate the weightings of GIC maturities within the GIC portfolio, including using regression analysis to maximize R-squared. These did not change the conclusions discussed here. The technique used below to calibrate these weightings was to match the average index duration since January 1983. This resulted in a 60% weighting in the 2-year GIC strategy and a 20% weighting each in the 3-year and 5-year strategy. The resulting comparison of the yields is as follows:

GIC Index vs Public Bond Market

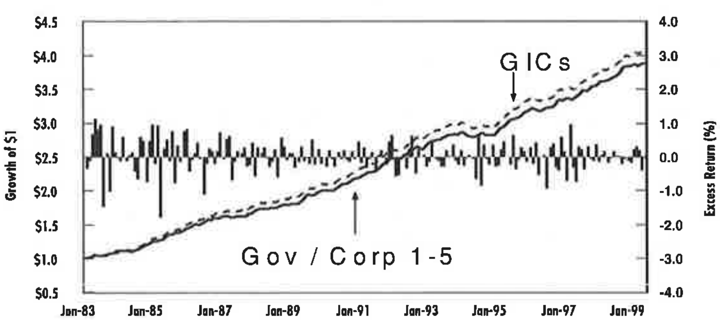


Source: IBM, John Hancock and Salomon Analytics

Again, recognizing that the credit quality of GIC issuers are higher than general investment-grade corporate debt and lower than US Treasury and agency obligations, the results appear to support the premise that GIC yields have historically been offered at competitive returns.

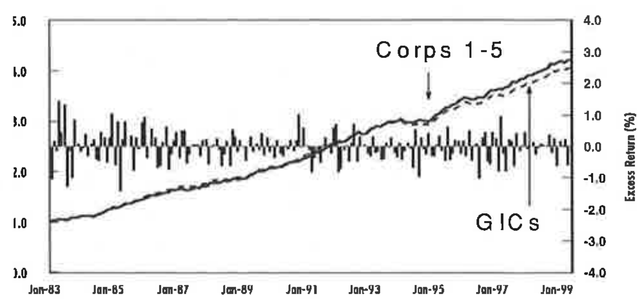
To get a better idea of the efficiency of GICs, a closer look at the returns generated by these indices follows:

GIC Index vs Gov / Corp 1 to 5 Index



Annualized Excess Return = +28 bps.
Beta = 0.97
R-squared = 0.74

GIC Index vs Corp 1 to 5 Index



Annualized Excess Return = -29 bps
Beta = 0.98
R-squared = 0.71

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Notice that the return performance of the GIC index falls squarely between the corporate and the government / corporate indices. Both comparisons show a reasonably good fit without any degree of systematic risk to give rise to the performance difference.

It is worth noting that the framework employed here omits any adjustment to the surrogate GIC index for realized default and loss experience in the early 1990s. While no definitive study has been done, this author is aware of some analysis by industry professionals. Again, while data is sketchy and interpretations may differ, a reasonable estimate for GIC annualized loss experience appears to be under 4 bps, perhaps considerably under. In any event, omission of this loss experience's impact on return does not change the validity of the analysis performed here.

Conclusions

The question of efficiency in asset pricing revolves around economic rates or return for equivalent levels of risk. Risk can be thought of as being comprised of several dimensions: liquidity, credit, sector, duration, active /passive and the risk of non-competitive returns. This article approached this question along a certain line of inquiry to reach its conclusions. Hopefully, at the least, it will be helpful in furthering the dialog on this topic.

This article set out to compare a passively managed GIC portfolio, a surrogate GIC index, against public market fixed income indices to demonstrate the risk / return efficiency of GICs using the familiar framework of portfolio indices. GICs seem to compare efficiently with traditional fixed income securities of similar duration and credit quality. This is true in spite of the dilemma that currently, GICs exist in their own sector outside of the benchmark composites.

As for liquidity risk, the GIC return series' were created out of GIC rates that were net of benefit responsive charges. In a sense, this corrects for the fact that these are private bonds being compared against public bond markets. GICs with benefit responsive insurance have very efficient liquidity built into their structure and covenants.

While this article didn't focus on active management within GICs, it is worth noting that the frequent change in sign of the excess returns from month to month between GICs and the public markets suggest that many tactical opportunities exist between these two markets.

In addition, with the absence of an economic returns-based GIC index, this analysis also demonstrates the efficacy of using a public bond index to benchmark a GIC portfolio. The challenge will be for a stable value manager to fit an appropriate index to the GIC strategy that he or she is utilizing. Oftentimes, an allocation to GICs is mandated by strategic policy for inclusion in these funds. This analysis points to a conclusion that these allocations should not be removed from the discretionary holdings of a stable value manger for the purposes of compiling a performance composite.

Retirement Security Not at Risk With Missouri Department of Insurance's Supervision of General American

Gina Mitchell, SVIA

Absent from the headlines and press accounts announcing that General American Life Insurance was under 'administrative supervision' by the Missouri Department of Insurance was the news that retirement security was not at risk.

The Missouri Department of Insurance (MDI) has reported that General American's crisis of confidence is limited to money market investors, not stable value funds or other retirement investment vehicles. MDI asserts that "General American's 300,000 policyholders and annuity holders are not at risk based upon what we know of the company - and we know a lot."

As reported, General American could not meet the demands for $6.8 billion in investment contracts, largely held by money market funds that were redeemable within seven days. Once rating agencies downgraded the company's financial strength, many money market funds began to redeem them since the company's new rating was below their investment guidelines. The resulting liquidity crunch, reports MDI's Randy McConnell, was from General American's mismatch of short-term liabilities against longer-term investments that could not be sold quickly enough to meet investors' redemptions.

Importantly, MDI's supervision gives the company time to liquidate its investments to honor the money markets' redemptions in a way that should not threaten investors including stable value investors who may be reminded of past insurance company failures. McDonnell emphasized that General American's woes are different from past failures saying, "Supervision is much different from placing it in receivership, in which the state takes over a failed company." The company has not failed and MDI predicts that a buyer will be announced shortly.

For updates on General American and other issues, check the Association's MEMBERS' ONLY at www.stablevalue.org.

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Today, self-directed brokerage accounts are broadening the need for equity wash rules. While brokerage accounts are not a "competing fund" per se, they can function that way since participants can invest in money market funds via brokerage accounts.

In fact, most self-directed brokerage accounts are set up so that contributions must go into a money market fund before being channeled into other assets, such as stocks, bonds or mutual funds. Accordingly, most plan sponsors have bowed to the demands of stable value issuers (including traditional GICs and synthetics) and agreed to classify their brokerage accounts as competing funds. (Stable value contracts are typically written so that issuers must be informed when a new investment option is offered within a DC plan, and to provide for an equity wash in the case of competing funds.)

Brokerage Accounts: A New Issue For Stable Value

This issue wasn't even on the radar screen for most plan sponsors until very recently. Five years ago, so few of them offered brokerage accounts in their DC plans that Spectrem Group (then Access Research Inc.), a financial services consulting firm in San Francisco and Windsor, Connecticut, didn't even keep tabs on them. Now it does, and in last year's survey it found that approximately 7% of the nation's 401(k) plan participants could access a brokerage account and that approximately 17% of those who could had. That's up from 4% and 13%, respectively, in 1996.

"I think the use of brokerage accounts will continue to grow modestly," says Jeffrey Close, Spectrem's director of marketing. "We see it used most often at two ends of the DC-plan spectrum: smaller, professional services type companies, and very large employers who simply want to provide as many options as possible to their employees."

Equity Wash Rules: A Way to Handle Competing Fund Issues

While equity wash rules are commonplace, they're not always popular with plan sponsors.

"Plan sponsors who've never had competing funds in their plans sometimes aren't familiar with the equity wash requirement, and aren't pleasantly surprised to find out about them," observes Kim McCarrel, a senior portfolio manager with stable value manager PRIMCO Capital Management in Portland, Oregon. "We've seen a number of them really struggle for a way to get around it, but I've never seen anybody do it."

"I wouldn't have put an equity wash requirement into our plan if the issuers hadn't forced me to, because I just don't like to put restrictions in our plan," says Don Butt, vice president of operations and defined contribution plans for U S WEST Investment Management Co. "But I know in this case we would have lost access to a significant portion of the bidding universe for stable value contracts if we hadn't done it."

Are Brokerage Accounts An Arbitrage Opportunity?

So far, arbitrage between stable value funds and brokerage accounts hasn't actually been a problem, although it's hard to tell if that's because equity wash rules work or because interest rates haven't moved sufficiently to test them.

"We don't see money draining out of stable value funds to go into other equity funds and then into brokerage windows," says McCarrel. "What we see is that between 5% and 15% of plan assets eventually migrate to the brokerage accounts, but usually not in the form of large lump-sum transfers. People just start putting new contributions into the brokerage account."

Accordingly, McCarrel says there's been no need as yet for her firm to increase its allocation to cash in its stable value portfolios.

Although most industry insiders say they've never seen a defined contribution plan that didn't have an equity wash rule to protect a stable value fund from competing-fund arbitrage, Marc Magnoli, a vice president in pension derivatives at Chase Manhattan Bank, is familiar with plans that have no transfer restrictions between the stable value fund and the brokerage account option.

"The issue for us is the stable value manager's ability to manage liquidity at least one level above the contracts," Magnoli notes. "If an equity wash is unacceptable, other sources of protection are available, such as having multiple tiers of liquidity, imposing fees for transfers, or having transfer prohibitions tied to interest-rate trigger levels. The downside to these alternative strategies is that they either reduce the fund's duration and hence expected returns, or are more difficult for the plan sponsor to administer and for the participant to understand."

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Magnoli says he's also seen plans that have an equity wash but allow direct transfers between competing funds once per year. The problem with this arrangement, he says, is that it becomes "a very expensive proposition." Why? Because the fund must be structured to have a significant percentage of its value in liquid investments on the dates that correspond with direct transfers. Additionally, issuers must price their stable value products higher to reflect the additional risk that such an arrangement carries for them.

"Wrap fees are based on the premise that participants, on the whole, will make investment decisions that are, for the most part, independent from changes in interest rates," explains Scott Carter, a vice president with Deutsche Bank. "Since the risk is dependent on two variables, interest rate increases and benefit responsive withdrawals, the probability of a payment by the issuer is reduced. Adding a competing fund increases the risk that participant behavior becomes more dependent on just one variable - interest rates. It's debatable to what extent an equity wash will impact the additional risk that a self-directed brokerage imposes. But in the end, if the risk becomes dependent exclusively on interest rates, wrap fees will begin to approximate the value of the interest rate protection that is provided," concludes Carter.

For now, it would appear that most participants in the stable value industry see equity wash rules as largely unavoidable.

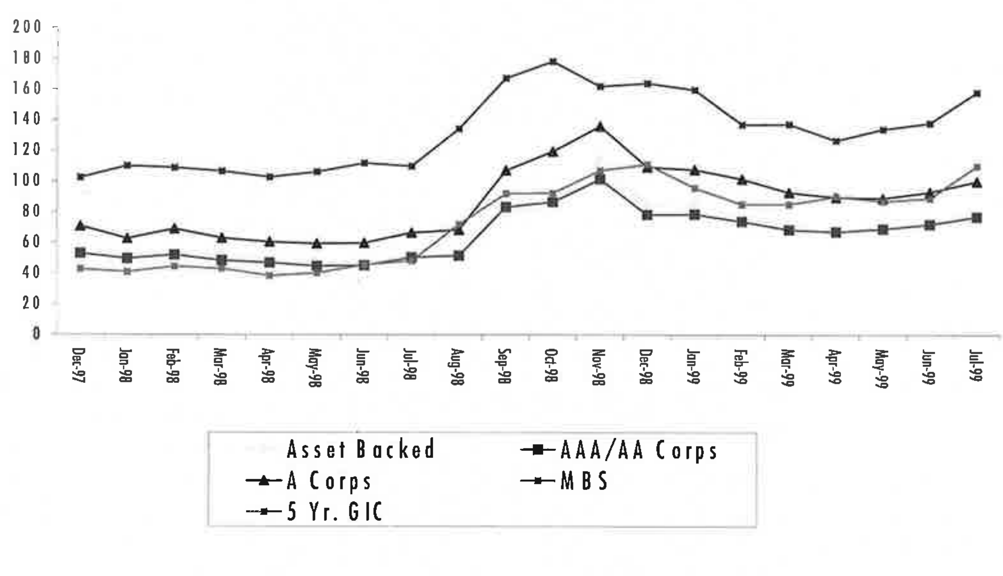
"An equity wash remains the cleanest, simplest, best-accepted method of protecting stable value issuers," says Magnoli. "Everyone in the industry is familiar with the equity wash provision, and there's not a lot of controversy."

Tracking Stable Value Yield Spreads: Interest Rate Commentary – 06/30/99

By Karl Tourville, Galliard Capital

Interest rates continued to rise in the second quarter as ongoing strength in the U.S. economy prompted fears of renewed inflation pressures and expectations of tighter monetary policy. The Federal Reserve did move in late June to tighten monetary policy a notch through a one quarter percent (25 basis points) increase in the Federal Funds rate, but they gave no indications as to further tightening moves.

Interest rates have seemingly stabilized around the 6.0% level on the 30 year U.S. Treasury bond, which represents about a 1.0% rise in rates thus far in 1999. As a result, most fixed income portfolios have experienced negative year-to-date returns when market price declines are factored in. Positively, however, risk premiums in certain of the non-U.S. Treasury sectors have narrowed somewhat, providing better relative returns for portfolios more heavily weighted in lower quality corporates and mortgage securities. Five year GIC spreads averaged around 90 basis points during the second quarter, but have widened subsequently to average about110 basis points in July. (The GIC spreads are calculated using the weekly average of the top ten spreads provided by the GIC issuers).



Making Better Investors: Are Asset Allocation Models The Next Step In Retirement Savings?

By Sean Hanna, 401KWire.Com

For years there has been one lament heard throughout the defined contribution and 401(k) plan industry: plan participants are poor investors!

No wonder a few startup firms are catching the interest of the industry. A list of the usual defined contribution plan providers reads like who is who of the conservative of the nation's conservative financial services industry. Yet, the firms capturing the interest of the market are Silicon Valley startups featuring everything out of the myth: venture capital funding, massive losses with little revenues, an unproven business model, and CEOs lacking the gray hair found in other industries. This mix of conservative financial service institutions and startups with corporate curriculum vitae shorter than a kindergartner's is where the future of the industry might be found.

First, A Little History

The advice firms are basing their business on a simple premise: technology — specifically the Internet — now allows the efficient distribution of top-quality investment advice to the average individual with an account balance in the low tens of thousands of dollars.

Taking the idea one step further, these firms targeted the defined contribution system as the ideal market into which to launch the advice concept. Unlike the retail advice business in which customers would have to be won over one at a time in what amounts to expensive trench warfare, the retirement plan industry held out the promise of a relatively quick sale to the plan sponsor. The plan sponsor would then act as the distributor of the advice to its employees.

For revenues, the advisors' business plans typically called for payments based on the number of participants in the plan. Usually, the hoped for fee landed somewhere in the $30 to $50 dollar range.

Through 1996 and 1997 the first wave of advice firms built their business based on these ideas. The two leaders down this path were Financial Engines and 401k Forum.

On the East Coast Rational Investors was working on a similar product with a different distribution twist. Rational's plan called on selling its product to bundled 401(k) provider rather than directly to the plan sponsor.

Meanwhile, Trust Company of the West (TCW) took a third path. The investment manager applied for and received a prohibited transaction exemption from the Department of Labor to provide advice to 401(k) participants. TCW's model was to offer a series of seven asset allocation funds to plan sponsors. TCW would then use a model developed by an independent advisor (Ibbotson Associates) to direct participants to one of those investment options that best fit their needs. Unlike the other firms, TCW would be paid an asset-based fee from the funds.

In November of 1997, Fidelity helped kick off the excitement over advice when FIRSco head Bob Reynolds held a press conference in New York City to introduce the concept to the media. Fidelity was careful to stress, though, that Portfolio Planner was not technically advice even though it picked specific funds for participants. Think of Fidelity's product as "aggressive education."

Fidelity's announcement both put advice on the map as a must consider feature of plan design. At the same time it had the effect of freezing the market as rivals waited to see the DOL's reactions to Fidelity's step.

Why Stable Value Needs to be On-Board the Asset Allocation Model Train

By Victor Gallo, Jackson National Life

Sean Hanna's article puts some real names behind the advice trend that we've all seen coming. I suspect it is more like a train than a trend. Stable value can get on this train, or risk missing it or, even worse, being run over by it.

We'll miss it to the extent that advice providers ignore stable value, recognizing only the standard asset classes of cash, bonds, and equities. While SVIA members are well aware of the role stable value has played, and can play, in participant portfolios, it cannot be assumed that the advice providers share this knowledge.

We'll be run over if the providers recognize stable value in a way that makes it seem unattractive relative to the competition.

Both of these risks stem from the relative obscurity and misunderstanding of stable value. Isn't it only recently that we've seen the name "stable value" mentioned in the mainstream financial press? And even in this issue of our own industry publication, we see the question, "What is stable value, anyway?" (Toward a New Model of Stable Value, page 12). This is why we need to keep in touch with the providers and work with them to ensure that stable value is clearly defined and fairly evaluated when advice is provided. The SVIA has a task force which is trying to do just that. Hopefully you will be at the Annual Forum to hear about the Task Force's progress and to learn more about trends in asset allocation models.

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"Making Better Investors" continued from page 8

The Rollout
If 1996 and 1997 were the planning years, then 1998 was the year that these products started to hit the street. Early adopters include Fujitsu and the SouthWest Airlines Pilot Association who signed on with 401*k* Forum and Alza Corp. which served as a beta site for Financial Engines.

What become apparent early on, though, was that few plan sponsors are willing to pay $30 to $50 per year for their employees to use one of these services.

Another hurdle for plan sponsors was their concern that they not increase their own fiduciary liability by offering one of these products.

The solution to these issues was for the advice firms to build alliances with bundled vendors to distribute the service to their plan sponsor clients. Key alliances were made by Financial Engines (Hewitt Associates, SSgA, Merrill Lynch), 401*k* Forum (Aetna, Hewitt Associates, Credit Suisse Asset Management), and Rational Investors (Pan American Life).

These alliances are good news in the opinion of Michael Gazala, research director at Forrester Research, Inc. (a technology-consulting firm). He believes that they "demonstrate that 401(k) vendors have put their stamp of approval on advice. This is definitely a plus," he says. "And since the advice-givers like Financial Engines and 401*k* Forum have knocked out multiple alliance deals with different plan providers, they are not in danger of losing their independence."

Steve Deschenes, president & coo at 401*k* Forum Deschenes feels that the alliances are only one mode of distribution, but there will be other models as well. He even forecasts that advice might be something that an individual participant could sign on for directly, but cautions that selling advice at the plan sponsor level made it more reasonable.

"This is the beginning of something pretty profound," contends Jeff Maggioncalda, president and CEO of Financial Engines. "Within six months, over 50% of the top ten vendors will have relationships with advice firms. In fact, that will extend down the line to top 25. It will be extremely common for 401(k) providers to partner with third party advice givers. The driver here is not that sponsors have realized that employees want advice. They already knew this. But sponsors now realize that advice is the good and safe thing to do." Optimistically, he adds that the trend is moving in the right direction. "The question is no longer is it too risky to offer advice, but whether it is too risky not to," says Maggioncalda.

Still, even as the number of alliances has mushroomed, and advice has become a part of the 401(k) request-for-proposal checklist, few plan sponsors are yet offering the service to clients.

The Present
A survey by Fidelity Investments of 1,116 participants in its system shows just how important the Internet is becoming to the average participant. "The Internet is now a mainstream account management

The Players

401kForum
www.401kForum.com
Based in San Francisco and now reorganized as a unit of Emergent Advisors. The firm is located in the SOMA district of San Franciso — an area associated with hot dot com firms. Its founder, Drake Mosier, came from Smith Barney where he was familiar with the brokers "TRAK" program. Ted Benna, widely noted as the "father" of 401(k), sits on the company's board.

Financial Engines
www.financialengines.com
A prototype Silicon Valley tech startup of the Nineties. Located in Palo Alto just down the road from Stanford University and the offices of Professors William Sharpe and Joseph Grundfest who reportedly hatched the concept for the idea in a Stanford cafeteria. CEO Jeff Maggioncalda is a twenty-something with a Stanford MBA. The company also boasts a high profile board featuring Olena Berg Lacy, who formerly headed the PWBA.

Rational Investors
www.rvest.com
Founded by Francois Gadenne and Ben Williams. CEO Gadenne hails from BankBoston and Arthur D. Little where he was team leader of the group that developed a weather forecasting expert system for NASA following the loss of the Challenger space shuttle. Williams, programmer, developed the DOS memory extender in his previous job. The pair sold the Rational to Standard & Poor's, a unit of McGraw-Hill, this year.

Ibbotson Associates
www.ibbotson.com
Founded by Yale professor Roger Ibbotson, the Chicago-based firm has a long track record as a consultant to the pension and investment community. First moved into the advice market as the developer of the advice model for TCW. Has since provided its capabilities to education firms including Weisenberger and Newkirk.

The Rest of the Field

TeamVest
www.teamvest.com
A Charlotte, NC-based administrator and recordkeeper serving the small plan market and founded by executives from TrustMark. Recently formed an alliance with Intuit to provide advice through Web portals.

Investment Technologies
www.invest-tech.com
A New York-based firm founded by Brian Rom in 1986. IT announced its entry into the 401(k) advice area in 1998.

DirectAdvice
www.directadvice.com
*A Hartford, CT-based startup that initially targeted the retail investor as Mentum. It has raised money from Japanese investor SoftBank Group and is said to be eyeing the 401(k) market. It is also rumored to be working with E*Trade, which has also raised money from SoftBank.*

AdvisorNet, LLC
www.avisornet.net.com
Owned by Chicago-based Marquette Associates this service was announced at the end of 1998.

"Making Better Investors" continued on page 10

"Making Better Investors" continued from page 9

channel for retirement savers. In fact, the volumes of contact 401(k) participants make through our online channel, NetBenefits, is exceeding the number of phone calls to retirement representatives. Virtually all 6 million participants serviced by Fidelity are Internet-enabled and we receive some 100,000 online contacts daily," states Kathryn Hopkins, executive vice president at the firm.

Fully 500 of the 1,116 surveyed use the Internet for personal finances.

- 85% use the Internet to check stock quotes,
- 75% use it to check their 401(k) balances,
- 49% use it to perform 401(k) transactions,
- And 36% use it for calculators and other online tools for retirement planning.

Fidelity expects usage of its online services to increase in the near future.

"We've made tremendous progress in the online channel in a very short period. As we work with plan sponsors to provide innovative tools such as PortfolioPlanner to assist with asset allocation strategies and expand the participant service features of NetBenefits, we expect the online channel to continue its meteoric rise," contends Hopkins.

Yet, today few Fidelity clients use PortfolioPlanner. TCW, which obtained a prohibited transaction exemption, is no longer heard from and the independents Financial Engines and 401*k* Forum (now renamed as Emergent Advisors) are adding venture capital, employees, and alliance partners at a furious rate. Still, few plan sponsors have taken the plunge after facing the issues of cost and liability.

The Future

The recent announcement by TeamVest that it has joined with Intuit to offer advice through Intuit's Quicken portal and the Excite@Home portal (Intuit provides the financial area to Excite.com) marks a turning point in the evolution of advice. TeamVest's strategy is to use the portals to go straight to the user of the product — the individual.

Financial Engines seems to be following a similar path. It recently revamped its website from a brochure targeted at corporate clients, partners, and investors into a retail site that delivers its Advisor product directly to the individual for $14.95 a quarter.

Financial Engine's Maggioncalda believes that when individuals need advice with 401(k) plans, the hurdle they are trying to leap across is not 401(k)'s but investing in general. "And needing help and advice with investing is the same whether we are talking about 401(k) plans, IRA's, or brokerage accounts," he opines. "Clearly, the investors who participated in the third round of financing at Financial Engines perceive the need and the opportunity that goes beyond 401(k)," Maggioncalda continues. "It's just starting."

"Advice will not stay focused on 401(k)'s," contends Forrester's Gazala. "Look at all the providers starting in the defined contribution space. They are answering a finite problem. Retirement is a finite goal. These providers will be looking to offer services in other financial areas. They will be exploring how their services can made available to a larger segment of the population, a segment that may never have had these kinds of products before."

"This will put a real pressure on human consultants, advisers, and brokers. They will now be challenged by the advice that is being provided online. They will have better educated customers. Individuals will not depend exclusively depend on Internet advice, but they will use it as a sounding board to get that second opinion," Gazala opines.

"Advice, though, is here to stay," the consultant concludes. "People still need help in making financial decisions. And they need that help regardless of whether they do not have the time, the interest, or the knowledge — which are all good reasons."

Ray Martin, principal at SSgA, also sees a bright future for advice, but he does have some concerns about the means of how that advice is communicated. "Participants need help and advice. How do you define a benefit from a defined contribution plan? This is no longer the old days when your employer picked your investment options for retirement. You have to make your own choices. And people want to know how to do that. And it is important that they know how to do that."

"Making Better Investors" continued on page 11

"Making Better Investors" continued from page 10

"Where I have questions is with communications. If you just do advice over the Internet, you are locking out a large number of people. A 401(k) provider should be trying to reach as many people as possible. That is why there is a need for both telephone call centers and Internet applications. Some people need a dialogue with a real person, an adviser. Why do people put their book orders into Amazon.com and then call one of that company's sales representatives to make sure the order has been received? Because there is a need for dialogue and human interaction that no advances in technology will cause to go away," Martin argued.

" There is one computer for every three households in America. That means two are without. You cannot cut those people out of the loop," he continues. "What I like about the Financial Engines service is that it offers our participants an array of probable outcomes," Martin states.

Steve Deschenes, president & coo at 401*k* Forum, shares some of Martin's concerns about communications. "As much as we believe in technology, we need to look beyond the Internet as the sole means of communicating with participants. We have been developing our telephone and paper means of communication. As this market develops, there will be a wider cafeteria of products with different price points. It will become a more segmented market and a more complex one," says Deschenes.

"You have to look at trend lines in terms of participation utilization. Participants use advice and have been incredibly satisfied with it, much more than with other elected benefits. And providers are reacting to the demands of participants," he continued.

401*k* Forum believes that advice will be ubiquitous in five years. "Like daily valuation, it has a period where it needs to be initially accepted. Then it will become the must-have product."

Deschenes also predicts that advice has applications beyond 401(k) plans. "Initially, 401*k* Forum will be expanding our advice into IRA roll-over markets, 457 plans, and 401(a) plans. And then we can expand into other areas as well," he stated.

The official also sees global applications. "One of the things we are exploring marketing of our services in countries like Japan and the United Kingdom where they are developing a 401(k)-like system," he concluded.

But there are those who sound a note of caution about advice as well.

"It is now a given that participants need advice," says Mark Davis, president and founder of Mark Davis Consulting (a California consulting firm that specializes in education for sponsors). "There is still a split as to whether or not sponsors need to be giving it. Sponsors have not been educated enough on advice. And there is still a mismatch in terms of content and delivery. Those who need advice the most are the ones who have the least chance of accessing it."

"Another current problem is that most advice systems are not actionable," Davis continued. "Once the participants get the advice they need, they cannot act on it. That is a spot where the system falls down. The participant has to go to another website or pick up the telephone or go to the human resources officer. This is a definite area for improvement."

"And the industry has allowed itself to think that online advice is the answer to all problems. That is not the case. You still need education. I think when you have told someone what to do, that advice should be wrapped in some kind of education so that participants have a context of understanding," he argued.

Got Ideas?

Stable Times needs your input - so if you would like to contribute an article or just have suggestions, please let us know. The *Stable Times* Editorial Board encourages your input. The Board's membership, phone numbers and emails are provided on page 2. Ideas for the Fourth Quarter Issue are appreciated before November 1.

OPINIONS: Toward A New Model of Stable Value

By Jeff Norris
Metropolitan Life Insurance Company

Recent volatility in the equity and fixed income markets has directed new attention to stable value funds - those often misunderstood investment offerings of many defined contribution plans. Sometimes tagged as overly conservative, the *intermediate-term-bond-yields-with-no-price-volatility* characteristics of stable value now look, if not attractive, at least, well, sensible. Plan participants, as a result, are acting sensibly and reassessing both their "financial needs timelines" and their "personal risk profiles" and are rebalancing their portfolios, often increasing allocations to stable value.

Stable value has long derived its identity from the fixed income world and, specifically, from comparisons with money market funds, hence the reason for some of the conservative stigma. Of course, stable value returns have long trounced those of their money fund rivals.

But must stable value remain a step-child to fixed income? We think not. In fact, the stable value asset class now has the opportunity to break out of its historical role as the conservative savings plan option and recapture the dominant position it held during the 1980s. In a reconstituted format, it can add significant value to participants in the way of increased returns and reduced volatility when compared to other savings plan options. Before looking at how this might happen, a glance back at how the asset class evolved will shed some light on the challenges stable value will face.

The Early Years of Stable Value

The original stable value offering was an insurance company contract that was evergreen in design with return characteristics that matched those of the insurer's general account. By definition, this meant that contracts were largely backed by fixed income investments which were generally long in duration. These were functions of both regulatory constraints and the liability profile of the insurer.

OPINIONS: New Feature

SVIA's Stable Times is pleased to launch an *OPINIONS* feature. *OPINIONS'* goal is to focus on new issues that captivate the stable value industry and stimulate a dialogue among the membership.

Jeff Norris has kindly volunteered to launch *OPINIONS* with his article, Toward A New Model of Stable Value.

OPINIONS' represents the views of the author. These articles do not necessarily represent the views of the Editorial Board or the Association. If you wish to submit a response to this article for the next issue of Stable Times, please contact Scott Matirne (202) 467-8013 or scott@stablevalue.org.

Interest rate volatility in the 1980s had a profound effect on general account-based products. When market rates went up, the result was a contractual rate which lagged. (Of course, in fairness, a longer duration portfolio also results in lagging, that is, above-market, rates when market rates fall). Why should this have been a concern? Well, in these early days of savings plans the return on the fixed option was thought to have to be competitive with what participants and potential participants would see in a bank window. *The savings plan was then seen to be competing with non-tax advantaged savings alternatives!* It was feared that plan contributions might dry up if the bank CD rate was better than what could be obtained within the plan. Because in these days the fixed fund would often garner 75% or more of participant contributions, an attractive credited rate was deemed absolutely crucial to the overall viability of the plan.

In this rapidly rising interest rate environment, insurance company providers worked to amend and restructure arrangements. Out of these efforts was born the GIC and also the specialty GIC consultant.

The Birth of GICs

With a fixed rate, fixed maturity product that now allowed for competitive bidding (no longer was the sponsor's fund underwritten by one provider) the GIC services business flourished. Insurers were still the only source of product and because stable value still looked more like a bond than any other investment, it remained very much tied to fixed income. Determined not to get caught long in duration, GIC consultants almost to a person favored short term contracts. The objective was (and in many ways, still is) to beat money market fund returns, but stay short enough to capture interest rate movement. Rules of thumb recommending 1/4 - 1/3 turnover of the GIC portfolio each year soon proliferated.

Perhaps the linkage of stable value with short duration fixed income returns served the stable value market and the defined contribution plan well in these early years. Double digit returns on this conservative plan option no doubt enticed many employees to participate in the plan, fueling its popularity and growth. The importance of this can easily be lost in today's context of higher participation rates and more savvy employee investors.

Managed GICs

The evolution of stable value took another step forward in 1989 with the introduction of managed GICs (a.k.a. separate account GICs, synthetic GICs). These products were essentially visible, segregated portfolios of fixed income securities surrounded by a book value guarantee, also called

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a wrapper. For purpose of our analysis, the important things to note are: 1) for the first time, plan sponsors could have direct input into the composition of the assets supporting their contract and, 2) the book value guarantee was designed to smooth out the potential volatility of investment returns, a mechanism previously buried and unseen in the operation of the insurer's general account.

So we now had the two components which ten years later can form the basis for our new stable value model - asset choice and a smoothing function.

And yet, the uses of managed GICs in recent years have continued to focus almost exclusively on fixed income securities. Within stable value, investment management mandates have been surprisingly limited. High quality, domestic securities benchmarked to intermediate duration indices overwhelmingly dominate managed GIC portfolios.

Rethinking Stable Value

One has to question now, however, whether the stable value conventions of today - borne out of the historical antecedents of defined contribution plan and stable value practices - need continue:

- *Is the plan still competing with outside savings alternatives?*
- *Does stable value still have to be tied to fixed income? To domestic fixed income?*
- *Does stable value still need to be managed to short durations?*
- *Are money market funds the true benchmark against which stable value should compete and be compared?*
- *Is tracking current market interest rates really so important?*

If the answer to any of the above questions is no, it might just be time to re-tune our definition of stable value. Maybe, it is time to ask a new question: *what is stable value anyway?*

In response, let's imagine a new stable value world order where equities and different classes of fixed income securities, heretofore rarely or never utilized, come into play. In this world, the Stable Value Fund is redefined as the Stable Diversified Asset Fund, perhaps similar to a balanced fund, with an important distinction - <u>the fund will always deliver a positive return.</u> This fund delivers market returns based upon the underlying assets, but smooths the results via the book value wrapper.

Maximizing the Wrapper

To make this happen will require a re-thinking on the part of buyers and sellers of the book value wrapper. In recent years, this component of the managed GIC has been given short shrift. Commoditized through look-alike contracts and price wars which denigrate the importance of liability management, the wrapper has become for some the necessary evil of stable value. Buyers and sellers often convince each other that these benefit withdrawal risks are de minimus.

Our new stable value world order, reinstates the wrapper in its prominent role as the "smoother extraordinaire" of the defined contribution world. It takes the potentially volatile returns of equities and other asset classes not heretofore associated with stable value and amortizes the peaks and troughs. The end result for participants is that they can now receive the higher returns of a more diversified asset portfolio, and not simply enhanced money market returns. And through the magic of modern portfolio theory, *more diversification* actually translates to *safer.*

It is not likely that all companies currently offering product to the wrapper market will want to step up to the demands of this new model of stable value. Sponsors and consultants will have the more challenging assignment of separating out those providers who possess the necessary skills to design and administer such an enhanced book value guarantee.

What about Performance?

If the facts alone ruled, our new model of stable value would be an easy winner. As the analysis in the Appendix (on page 19) demonstrates, even the simple decision to move to a benchmark longer in duration (i.e., from intermediate to broad market duration) can reasonably be expected to increase credited rates with no negative impact on volatility. Sprinkling in other fixed income assets and even including equities continues the pattern: higher returns with lower volatility.

Can it Happen?

In conclusion, we might ask some final questions.

- Can the *facts* of "higher returns with lower volatility" outweigh the *emotions* of "shorter duration and higher quality" that is so much a part of current stable value design?
- Is it possible that plan sponsors and stable value providers will expand the boundaries of this asset specialty and that stable value can become more than simply a revved-up money market fund?

In fact, it has already begun to happen. At MetLife, we have a small but growing list of clients who have begun to augment their stable value funds by purchasing managed GICs backed by something other than high quality domestic fixed income securities. High yield and international fixed income, longer duration mandates and even equities are currently being utilized. To date most of these allocations are small. However, there is a clear trend toward opening up the investable universe for stable value. The end result of pushing the frontier will be a more robust stable value asset allocation which delivers better returns to the ultimate beneficiaries.

Appendix to "A New Model" located on page 19

Growth Predicted in the "Stable Value Investing GICs'99" Survey

By Greg McGreevey, ING Institutional Markets

Introduction:

At the 13th Annual Symposium on Stable Value Investing, GICs '99, certain attendees provided their input to a survey that covered a number of key issues within this industry. This article provides a brief overview regarding the responses we received as well as some commentary regarding these results. Responses were received from over 30% of the 350 plus attendees at the conference. We have grouped these responses into three categories in order to provide more consistency between the various survey questions:

- ·Growth of Markets
- ·Underwriting Issues
- ·Investment Allocation & Analysis.

The first of these categories will be covered in this month's *Stable Times*, with the other two sections being addressed in later issues.

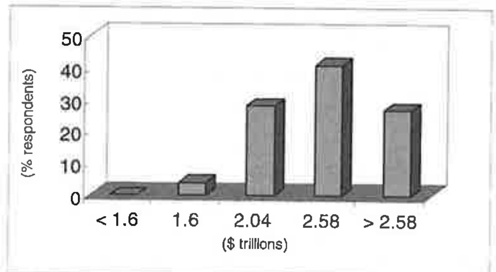
Growth of the Markets:

Stable Value Market

The first five questions of the survey dealt with individuals' growth expectations in a number of key markets within the broadly defined stable value industry. The first question related to the total expected growth in the 401(k) market and the expected percentage allocated to stable value funds. **96%** of respondents felt that total assets in the 401(k) market would grow at an average annual growth rate of **5% or greater**, with over two-thirds of respondents believing that such annual growth would be at or above 10%. Over **80%** of the survey responses indicated that stable value would capture at least **15% of the total 401(k) assets**, with about half believing this percentage would be at least 20% or greater.

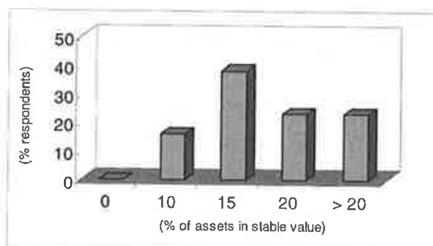
Taken together, these numbers would assume strong growth of stable value given the perceived growth in the 401(k) market and the fact that respondents felt that stable value's allocation would remain at the same levels as today. That is, the stable value market would simply grow at the same level as the aggregate 401(k) market.

401(K) MARKET SIZE



What will 401(k) assets be in 5 years?

401(K) MARKET SIZE
Stable Value Percentage

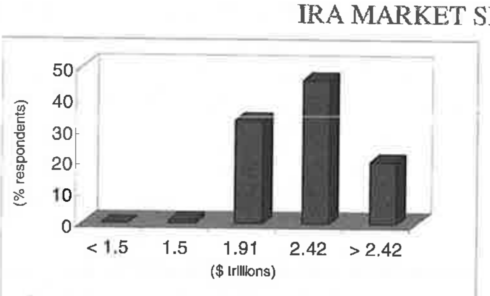


What % of 401(k) assets will be in stable value in 5 years?

IRA Market (Qualified)

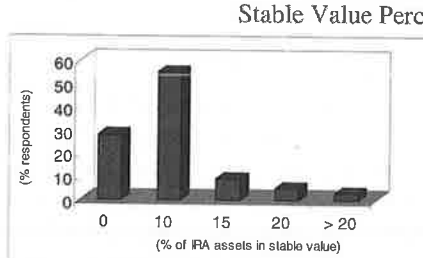
The second question dealt with expected growth in the IRA market, a potential new market for stable value managers. **99%** of those surveyed felt that this market would grow at least at an **annual average rate of 5%** over the next five years. It appears that total respondents based their opinions on the aging domestic population base. When it came to how much of this market would be allocated to stable value, respondents were less optimistic when compared to responses in the 401(k) market. Specifically, nearly **three-quarters** of those providing responses felt that stable value would capture **10% or less** of this sector's assets within the next five years. These numbers are most certainly reflecting the time it takes to build brand name recognition and distribution into the new market segment, stable value retail mutual funds.

IRA MARKET SIZE



What will IRA assets be in 5 years?

IRA MARKET SIZE
Stable Value Percentage



What % of IRA assets will be in stable value in 5 years?

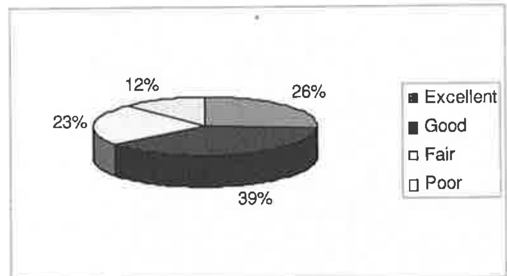
"Survey" continued on page 15

"Survey" continued from page 14

International DC Market (Qualified)

The third question moved into the qualified international marketplace by obtaining responses to expected growth in the global DC market by April 2004. As many readers know, many foreign countries have begun to move away from country - or employer-based benefit plans in favor of 401(k)-like plans. The responses to this question were somewhat mixed, with a bias toward favorable growth. Specifically, roughly **two-thirds** of respondents believed that the global defined contribution market would provide **excellent** or **good** growth opportunities for stable value players, with the remaining respondents believing that growth in this sector would be only **fair** or **poor**.

GLOBAL DC MARKETS
Growth Opportunities

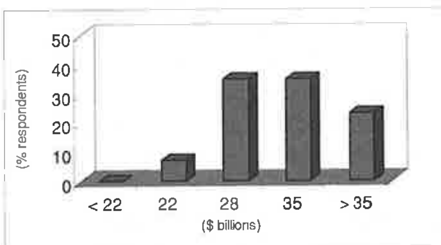


What are the growth opportunities for stable value within global DC plans in 5 years?

Domestic Funding Agreement Market (Non-Qualified)

The fourth question on the survey related to the domestic non-qualified market, which has contributed to a large percentage of insurance companies' growth in recent years. The domestic funding agreement market was created within the last eight years to enjoy total annual sales that are almost equivalent to the entire annual sales in the qualified retirement market for stable value products. Of those that responded, over 90% believed that average annual growth in this market would continue to occur, albeit not at the level experienced in the prior years. **93%** of those participating in the survey believed that this market would grow at an **average annual rate of 5%** or more in the next five years. About **25%** of respondents believed such growth would be an average annual growth rate of **over 10%**. Buyer capacity limitations and rating agency concerns will likely be offset by the new applications for funding agreements in this market for this growth to continue.

DOMESTIC FUNDING AGREEMENT
Annual Sales Expectations

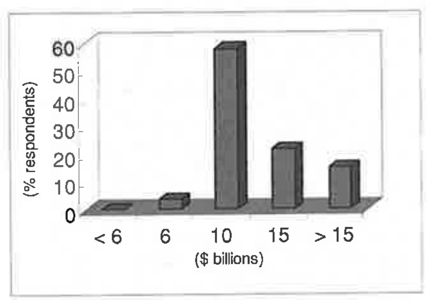


What will annual new sales be in the domestic funding agreement market in 5 years?

International Funding Agreement (Non-Qualified)

Finally, the last question within this category had to do with growth in global funding agreement placements over the next five years. Total placements in this market have increased at an extremely rapid rate, with a number of large domestic insurance companies and other entities accessing the capital markets in Europe and Asia. Respondents believed that such growth would continue at a brisk pace, with **over 96%** of those surveyed believing that average annual growth would be at or **above 10%**. The current explosion in European medium-term note programs provides strong indication that those participants that responded to this question will probably be correct, at least over the short term.

GLOBAL FUNDING AGREEMENT
Annual Sales Expectations



What will annual new sales be in the global funding agreement market in 5 years?

Conclusion:

It is apparent from those that provided responses to the survey of their optimism for potential growth in the stable value market if defined to included both domestic and non-domestic products. While these questions were most relevant to issuers of stable value products in these sectors, such growth also pertains to all players in these market segments. We look forward to continuing our series ....

Getting the Work Done: A Look at SVIA's Committees

By Allan Fen, Fen Associates & Gina Mitchell, SVIA

SVIA has six committees which direct the Association's work. This article provides you with an overview of their make-up and key activities.

Getting the Word Out

SVIA's Communications & Education Committee is responsible for spreading the gospel on stable value funds. It's a simple message that is repeated often by the Committee:

- Stable value provides superior risk adjusted returns relative to other similar fixed income investments.
- Stable value is safe and provides stability of principal and consistent earnings unlike any other investments.
- Stable value is an excellent diversification tool for retirement savings.

Although SVIA is diligent in getting the message out, it seems to resonate most when the equity markets slide or correct (remember last Fall's coverage by CNN, NBC and ABC).

Most recently, the Committee has been looking for greater Internet exposure. "We are looking to reach out to individual investors by positioning SVIA as an investment expert and resource," explains the incoming committee chair, Kim McCarrel. To date, SVIA is linked to www.BlackFamilies.com and moneycentral@msn.com. SVIA has also been featured on other Internet publications such as the fundforum@TheStreet.com and www.401kWire.com.

The Committee gets the word out through its Media Team. The team serves as a sounding board and crafts talking points for SVIA's message. The Association's President, Gina Mitchell serves as the spokesperson. However, the Media Team also supports her by serving as an additional resource to the press.

The Communication and Education Committee has two other working groups under its belt: the Stable Times Editorial Board, which is responsible for the Association's quarterly newsletter and the Internet Group, which is responsible for www.stablevalue.org.

Stable Times: The Resource for Stable Value Information

"Stable Times, our quarterly newsletter, demonstrates how far we have come. The newsletter is entirely member-driven both in content and effort," explains the Communication & Education Committee's current chair, Kelli Hueler. "The Stable Times Editorial Group has moved the newsletter from an internal communication vehicle for Association members to the source for information on issues pertinent to our industry and the trends that shape stable value for those totally new to stable value and our members," says Hueler. "The progress that has been made in a little more than two years is amazing. When we started the newsletter, we were worried if there was enough content to keep it going. Now the Editorial Group struggles to decide which stories to focus on now and which ones can wait," states Hueler.

However, one thing remains the same, emphasizes Hueler and McCarrel, Stable Times is member-driven. The newsletter and the Editorial Group encourage and depend upon story ideas and articles from SVIA members.

Communication & Education Committee
The Committee is devided into three working groups: Media Team, Stable Times Editorial Board and www.stablevalue.org. Their membership is listed below.

Co-Chairs: Kelli Hueler, Hueler Companies
Kim McCarrel, PRIMCO

Media Team
Bill Bonacci, MetLife
Connie Dorval, Diversified Financial Products
Joe Fournier, John Hancock
Jon Fraade, AIG
Kelli Hueler, Hueler Companies, *Co-Chair*
Kim McCarrel, PRIMCO, *Co-Chair*
Robert McCormish, Certus Asset Advisors
Jason Psome, Deutsche Asset Management
Richard Taube, Pacific Life
Karl Tourville, Galliard Capital

Stable Times Editorial Board
Gary Bacchiocchi, MassMutual
Wendy Cupps, PIMCO
Allan Fen, Fen & Associates
Jamie Guenther, PRIMCO
Dave Leroux, Jackson National Life
Dan Libby, IBM
Vicky Paradis, J.P. Morgan
Janet Jasin-Quarberg, Hueler Companies
Karl Tourville, Galliard Capital
Greg Wilensky, Sanford C. Bernstein

www.stablevalue.org
Kim McCarrel, PRIMCO
Barbara McLean, ING
Karen Watson, Baxter

Data & Research Committee
This committee also has two task force groups whose membership is distinct from the full committee.

Chair: Klaus Shigley, John Hancock

Dean Benner, Brundage, Story & Rose
Wayne Gates, John Hancock
Eileen Leonardi, Fidelity
Dan Libby, IBM
Judy Markland, Landmark Strategies
David McNiff, Eastman Kodak
Joe Mickelson, American Express
Jason Psome, Deutsche Asset Management
Ivan Rudolph-Shabinsky, Sanford C. Berstein
Elliot Rosenthal, GE Life & Annuity Assurance Co.
David Wray, Profit Sharing/401(k) Council

Asset Allocation Task Force
Chair: Stephen LeLaurin, PRIMCO

Wayne Gates, John Hancock
Jamie Guenther, PRIMCO
Paul Lipson, Federal Reserve Employee Benefit Systems
Klaus Shigley, John Hancock
Bruce Vane, Certus Asset Advisors

"SVIA's Committees" continued on page 17

"SVIA's Committees" continued from page 16

So, if you have an idea or would like to write an article for the next issue, please give SVIA's Gina Mitchell a call.

Internet Ready: www.stablevalue.org
SVIA has revamped the Association's Internet site to make it more responsive to users. "We changed hosts, we've reorganized the site and it is paying off," explains SVIA's Administrative Coordinator Scott Matirne. With our old site, the .com, we averaged roughly 300 visits a month. With our new site, www.stablevalue.org, we are reporting between 20,000 to 25,000 visits a month, and we've only had the new site for three months," says Matirne.

"The Stable Value Glossary seems to attract the most visitors with the Conference Center running second," reports Matirne. Matirne predicts that site visits will increase now that SVIA's site is listed on the top 500 browsers.

The MEMBERS' ONLY SECTION is now interactive. Matirne notes that almost 50 percent of the 1999-2000 Directory updates have been made on-line. Additionally, key Association initiatives are now available in this section. On the soon-to-be-added list, is an SVIA bulletin board to encourage peer-networking and SVIA press archives.

Data & Research: The Numbers That Give SVIA Credibility
The Data & Research Committee, chaired by John Hancock's Klaus Shigley, could be described as the "Joe Friday" of SVIA's committees since it provides the facts—SVIA's numbers. Through the Committee's work on such projects as the Third Annual Stable Value Investment Policy, key data is obtained that determines the size of the stable value market and investment trends within the industry. These trends include duration, credit quality and crediting rate that can be used by the membership to determine how they compare with other stable value funds.

The Committee also oversees a joint biannual survey with LIMRA on Product Sales. The SVIA-LIMRA survey also collects information on funding agreements.

Shigley reports that the Committee is about to kick off the research and development phase of the "Nifty-Fifty" stable value index. The Committee is starting to dialogue with a hand full of plan sponsors on the creation of the index. He explains, the Committee's idea is to track quarterly crediting rates of the fifty largest stable value funds. The aggregate of all fifty plans would serve as a book value index for the industry.

Asset Allocation Task Force: Looking at Models
The Task Force is evaluating not only the proliferation of advice firms offering asset allocation models but also how these models treat stable value funds and who is currently using the models. The Task Force's initiative is to educate the model providers about stable value to try and ensure that stable value is represented and is properly portrayed.

Performance Measurement Task Force Enters Phase Two
The Data & Research Committee's Task Force on Performance Measurement completed a major milestone: the issuance of its draft report in late February of this year. The Report recommended using total return calculations using fair (market) value of underlying assets, in addition to book value, when making performance comparisons between stable value funds and with benchmarks. "Fair value's use is common place in other asset classes," reports Task Force

Performance Measurement Task Force
Co-Chairs: Paul Donahue, PRIMCO
Dan Libby, IBM

Peter Barcia, Deutsche Asset Management
George Baumann, PRIMCO
Karen Chong-Wulff, DuPont
Wendy Cupps, PIMCO
Ty Danco, Dwight Asset Management
Kelley Fairbank, Frank Russell
Chris Freese, The Principal Group
Allan Fen, Fen & Associates
Robert Galuzca, Fidelity
Susan Graef, Vanguard
Kathy Hyland, Vanguard
Paul Kraft, Deloitte
Jim McKay, American Express
Vicky Paradis, JP Morgan
Klaus Shigley, John Hancock
Mark Shoemaker, T. Rowe Price
Karl Tourville, Galliard Capital

Budget, Finance and Oversight Committee
Chair: Jim McDevitt, State Street Bank & Trust

Eric Kirsch, Deutsche Asset Management
David McNiff, Eastman Kodak
Judy Wilson, Protective Life

Government Relations Committee
Chair: Alfred Turco, Pepe & Hazard

Tony Camp, Aetna
Victor Gallo, Jackson National Life
Sandy Koeppel, Prudential
Helen McGreevy, J.P. Morgan
Jim McKay, American Express
Tom Roberts, Aetna
Christina Stiver, Transamerica

Membership & Dues Committee
Chair: Tami Pearse, Deutsche Bank

Doris Fritz, Fidelity
Bill Gardner, Dwight Asset Management
Marian Marinack, Federated
Judy Wilson, Protective Life

1999 National Forum Steering Committee
Co-Chairs: Robert Angelica, AT&T
Gina Mitchell, SVIA

Peter Brigando, New York Life
Joe Fournier, John Hancock
Bill Gardner, Dwight Asset Management
Thomas Hartlage, Diversified Financial Products
Maryann Segreto Lamb, C N A
Scott Matirne, SVIA
John Milberg, Pacific Life
Randy Paas, PRIMCO
Joseph Saleh, Deutsche Bank
Ken Walker, T. Rowe Price
Judy Wilson, Protective Life

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"SVIA's Committees" continued from page 17

member Allan Fen. "However," he notes, "it is starting to be for stable value with wrapped bond funds."
IBM's Dan Libby and PRIMCO's Paul Donahue will lead Phase Two of the Task Force. A major thrust of the Task Force's work will be promoting the Task Force Report and working to get a consensus on the use of fair value, as one of the accepted methodologies for evaluating performance among the different stable value constituents such as consultants, managers, issuers and plan sponsors.

Budget, Finance and Oversight: SVIA's Newest Committee

SVIA spun-off the Committee on Budget, Finance and Oversight from the Committee on Membership and Dues earlier this year. The new Committee chaired by State Street's Jim McDevitt is responsible for overseeing SVIA's administration and financial arrangements now that SVIA has taken on those functions internally in the Washington Office. The Committee is responsible for SVIA's $750,000 budget, which includes a $160,000 budget for the 1999 National Forum.

Government Relations

The Government Relations Committee is charged with monitoring all federal and state developments that may impact stable value funds. The Committee Chair, Al Turco from Pepe & Hazard reports that the Committee has spent almost a year looking into how the Department of Labor regulates synthetic GICs. The Committee oversaw the creation of a Working Group and an Issuer Advisory Group on synthetics. The Working Group recently filed an application for a Department of Labor prohibited transaction exemption on synthetic GICs.

SVIA's Board of Directors is supportive of the proposed application and has identified disclosure to plan participants and evergreen contracts as key issues for SVIA's Government Relations Committee. Turco predicts that the Committee will begin a direct dialogue with the Department of Labor on these two issues.

Membership and Dues: Producing the Revenue for SVIA's Mission

The Committee on Membership and Dues has two complimentary goals: increasing/retaining members and raising revenue or dues for the Association. To date, the Membership and Dues Committee has exceeded its $300,000 target by 10% despite implementation of a dues increase (Dues rose from $3,000 to $5,000 for service firms. However, for plan sponsors dues remained at $195.)

The Committee Chair, Deutsche Bank's Tami Pearse explains that roughly half of the Association's revenues are dependent on dues. The rest, 37% comes from the Value Program, which was implemented this year. The remaining 12% will come from the 1999 Conference.

Value Program's First Year

SVIA To date, reports Pearse, we raised about 80% of the Value Program's $220,000 hurdle. As of July 30, SVIA' Value Program members include:

American Express
C N A Insurance Company
Certus Asset Advisors
Deutsche Bank
Diversified Financial Products, Inc.
Dwight Asset Management
Galliard Capital Management
Jackson National Life
John Hancock Financial Services
GE Life & Annuity Assurance Company
MBIA Insurance Corp.
Metropolitan Life Insurance Company
New York Life Insurance Company
Pacific Life Insurance Company
PRIMCO Capital Management
Protective Life Insurance Company
Prudential
Sanford C. Bernstein
State Street Bank & Trust Company
T. Rowe Price

Explains Pearse, "We have been really pleased at the generosity and commitment of the Value Program Members to SVIA's mission. This is the first year that we have institutionalized our outreach. Before, we raised funds for the Association on an ad hoc basis. The Value Program members' financial commitment to the Association has only been exceeded by the time and effort of their professional staff in working towards achieving the Association's goals."

1999 National Forum Steering Committee: New Opportunities, New Frontiers

The National Forum Steering Committee is responsible for SVIA's October 12-14 New Opportunities, New Frontiers Forum. The Forum will explore the major issues before the stable value industry and the major trends that shape the industry. The Forum focuses on mainstreaming stable value; key defined contribution issues that affect the industry here and abroad, global opportunities, and hands-on debate on issues such as par vs. non-par value. To get the latest information on the National Forum, check Conference Center at SVIA's www.stablevalue.org.

"A New Model" continued from page 13

APPENDIX
Toward a New Model of Stable Value

To determine the expected returns of adding non-traditional assets to stable value we examined several portfolio constructions shown below. Returns were calculated over the period 1989 - 1998.

Portfolio	Composition
A	Lehman Bros. Intermediate Government/ Corporate Bond Index
B	Lehman Bros. Aggregate Bond Index
C	Lehman Bros. Aggregate Bond Index (80%) + High Yield (20%)
D	Lehman Bros. Aggregate Bond Index (60%) + High Yield (20%) + International Bonds (20%)
E	Lehman Bros. Aggregate Bond Index (40%) + High Yield (20%) + International Bonds (20%) + S&P 500 (20%)

While relatively straightforward to compare on a market value basis, the book value nature of stable value required that we artfully make and apply certain assumptions to these portfolios for purposes of comparing credited rates. These assumptions dictated the **yield-to-maturity** that we utilized in our standard rate reset formula and the **duration** over which we amortized market value performance.

Asset Class	Assumed Net Yield-to-Maturity *	Amortization Period *
Intermediate duration bonds	Lehman Bros. Intermediate Govt./Corp. Bond Index	3.3 years
Market duration bonds	Lehman Bros. Aggregate Bond Index	4.5 years
High yield bonds	Lehman Bros. Aggregate Bond Index + 0.60%	4.6 years
International bonds	Merrill Lynch Global Govt. Bond Index II (ex. U.S.) + 0.50%	4.4 years
Equities	Lehman Bros. Aggregate Bond Index + 2.00%	7 years

* Portfolios A - E use the weighted average of these depending upon the portfolio composition.

The results confirm that more diversification can lead to higher returns with reduced standard deviation.

Portfolio	Average Credited Rate	Standard Deviation
A	7.98%	0.88%
B	8.48%	0.82%
C	8.73%	0.50%
D	8.64%	0.53%
E	9.54%	0.34%

As a further exercise, the above numbers were recalculated utilizing a standard amortization period of 3.3 years, consistent with Portfolio A. This had the expected result of increasing both returns and volatility. Plan sponsors will want to consult with their providers to model the effects of various amortization schedules depending upon the assets they choose to include.

Portfolio	Average Credited Rate	Standard Deviation
A	7.98%	0.88%
B	8.63%	0.95%
C	8.91%	0.63%
D	8.85%	0.76%
E	9.99%	0.60%

A final word of warning concerns the sine qua non of any analysis based upon an historical fact pattern. The past ten years which provide the data for this examination have seen strong bond market returns coupled with a raging bull market for equities, both of which play a role in the results shown.

Stable Value Remains True To It's Name

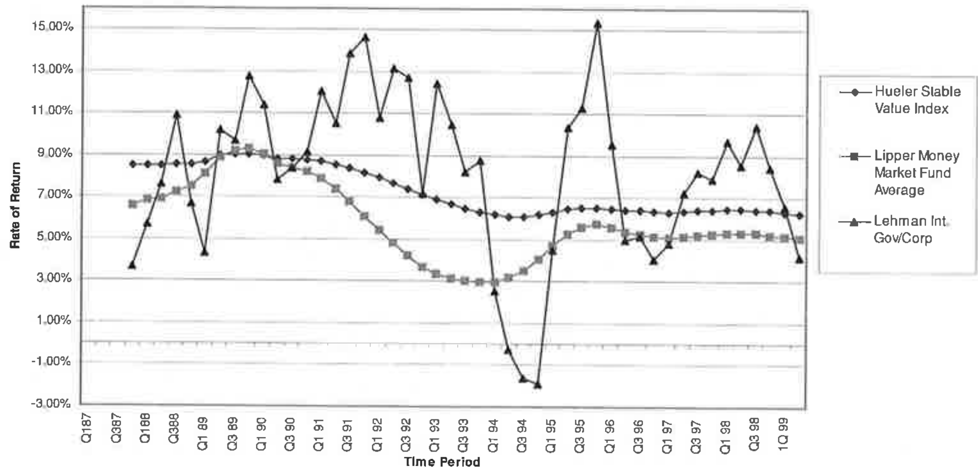
By Janet Jasin Quarberg, Hueler Companies

The Hueler Stable Value Index has outperformed Lipper's Money Market average by greater than 100 basis points annually over the past one, three and five year periods. In addition, the Hueler Index has outperformed the Lehman Int. Gov/Corp Index by over 200 basis points over the past 12 months.

Volatility for the three indices differs significantly. Over the past five years, the standard deviation for the Money Market and Stable Value Indices are almost exactly the same, hovering at 11 and 9 basis points respectively. While for the same time period, the Lehman Intermediate Gov/Corp shows significant volatility at 253 basis points, which equates to almost 30 times more volatility.

As demonstrated, stronger return performance and less volatility provides additional support as to why stable value funds should be a core investment option in defined contribution plans.

Fixed Income Investment Asset Classes



As of 6/30/99	***Hueler Stable Value Index***	***Lipper Money Market Average****	***Lehman Intermediate Gov/Corp***
1 Year Return	6.25%	5.11%	4.19%
3 Year Return	6.36%	5.21%	6.64%
5 Year Return	6.39%	5.26%	7.04%
5 Yr Standard Deviation	0.09%	0.11%	2.53%

The Lipper MM returns have been grossed up by an average Lipper fee of 39 bpts.

New at SVIA

Register Before August 27 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:

- ***William Sharpe***, is an Economics Nobel Laureate and Co-Founder and Chairman of Financial Engines, which provides online 401(k) investment advisory services to individual consumers.
- ***Ed Yardeni***, the Chief Economist, Global Investment Strategist and Managing Director for Deutsche Bank Securities. Doctor Yardeni is recognized as the leading expert on Y2K.
- ***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.
- ***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.
- ***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.

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

Have You Made Your Hotel Reservations?

SVIA has reserved a limited number of rooms at SVIA's conference rate for National Forum Attendees. Please call the Monarch Hotel at (202) 429-2400 before **September 13, 1999** to guarantee this special rate. The rates are *Deluxe* $229, *Executive Club* $259, and $289 for *Premier.*

MEMBERS ONLY

While on the Internet, remember to try out SVIA's new MEMBERS ONLY section. If you have forgotten your username or password, call Scott Matirne (202 467 8013) to get immediate access.