STABLE TIMES

The quarterly publication of the Stable Value Investment Association — Volume 7, Issue 1 ¥ First Quarter 20

IN THIS ISSUE

Stable Value Gains in College Savings Market — 1
Aruna Hobbs
AEGONInstitutional Markets

401(k) Investors Flock to Stable Value — 1
Randy Myers

New Kids on the Block:TIPS — 1
Greg Wilensky and Justin Egan, Alliance Capital, Wendy Cupps, PIMCO

Paradis Elected SVIAChair — 1

Editor's Corner — 3
Wendy Cupps, PIMCO

Pension Security Act Passes House Committee — 7
Gina Mitchell, SVIA

A Role for Inflation Protected Securities in Stable Value Funds? — 7
Greg Wilensky and Justin Egan, Alliance Capital, and Wendy Cupps, PIMCO

New Chairs Named — 7

Positive Stable Value Cash Flow Trend in 2002 — 8
Kathleen Schillo, Hueler Companies

2001 EBRI/ICI 401(k) Data Shows Small Changes — 9
Gina Mitchell, SVIA

Scrambled Eggs: Bush Savings Proposals Start Discussions — 10
Gina Mitchell, SVIA

Increase for 2002 Stable Value Sales — 10

Diversification and Increased Savings are Unintended Consequences — 11
Gina Mitchell, SVIA

Eliminating the Double Taxation of Dividends: An Old Debate with a New Twist — 12
Gina Mitchell, SVIA

Stable Value Gains In College Savings Market

Aruna Hobbs
AEGON Institutional Markets

A couple of years ago, the c
savings market was unch
land for Stable Value prov
Many believed the potential fo
Value was a perfect strategic f
college savings investments E
new growth market for Stable

Today, Stable Value has b
a popular investment option ir
booming market, with plenty o
for growth and product evoluti

Thanks to generous feder
incentives last year, the entire
savings marketplace has seer
sive growth, accompanied by
new entrants and intense com
among plan providers. yIndust
growth projections are temper
by the recent Bush Administration
savings proposals. And, Stable Value
has taken its place at the tabl
Today, all 50 states offer 529
savings plans. More than 4 m
accounts have been establish
year-end 1999. In that same
529 assets have grown nearly
to some $23 billion, with most
growth occurring in the last tw
years. Cur industry growth pr
jections put 529 assets at $1
by 2010, but extrapolating fro
curent growth rate, we think a
could grow to more than $20
in the next seven years. Give
statistics, itÕs no surprise tha
stories on this market abound

continued on page

Paradis Elected SVIA Chair

Victoria Paradis was unanimous
ly affirmed as the next SVIA
Chairwoman by the Board of
Directors at its February 13 meeting
Vicky will serve as Chairwoman-elec
during 2003, which is the last year o
Eric KirschÕs term as Chairman. Sh
will serve as Chairwoman of the
Stable ValueÕs industry association
from 2004 through 2005.

Vicky serves as a vice president
and portfolio manager in the

continued on page 2

401(k) Investors Flock to Stable Value

Randy Myers

Stock market returns
have been miserable
for the past two years,
making the gains posted by
Stable Value funds look
positively stellar.
Nonetheless, vendors who
advise retirement plan
investors on where to stash
their money say their com
puter models arenÕt recom
mending Stable Value
funds any more frequently
than they did in the past.

"One of the charac
teristics of our advice
framework is that weÕre not
trying to help participants
arbitrage the difference
between market rates
(or return) and the creditin
rates of Stable Value
fundsÑtime the market
you will," says Chris Jo
executive vice preside
financial research and
strategy, for investmer
advisor Financial Engi
What that implies is th
the allocations we rec
mend into fixed incom
versus equity versus S
value or any other inve
ments tend to be quite
ble through time." Dav

continued on page

New Kids on the Block: TIPS

Greg Wilensky and Justin Egan, Alliance Capital
Wendy Cupps, PIMCO

An increasing number
of TIPS (Treasury
Inflation Protected
Securities) fund offerings,
combined with recent dou
ble digit returns, has fueled
interest in, and allocations
to, TIPS within the defined
contribution marketplace.

In this article, we
explain the attraction of
TIPS, how they compare to
nominal bonds, and how
they perform in different
market environments. This
may help the reader better
understand how TIPS can
be positioned within the
array of defined contribu
tion options offered to par
ticipants. We also explor
the important question,
"Do TIPS Compete with
Stable Value?"

The Attraction of TIPS

Their face value is adjusted
daily to reflect the changes
in the cost of living (CPI)
that are reported by the
Bureau of Labor Statistics
each month. This indexa
tion is structured to protect

continued on page 3

Stable Value Gains

continued from page 1

Most important: the number of states offering a Stable Value guaranteed option has increased by a whopping 320%Ñto 21 up from 5Ñ and the number is growing all the time. In 1999, to the best of our knowledge, only TIAA-CREF provided any type of Stable Value guaranteed option in this market. Today several firms are providing Stable Value to the 529 market, including AEGON, Alliance, INVESCO, Prudential, Putnam, Strong and Travelers, to name a few. Many managers are currently in active discussions with various plans.

Stable Value is typically available as a standalone option within 529 plans, but thereÕs room for much more growth. Most college savings plans offer a pre-mixed asset-allocation progression based on the childÕs age, which is a popular choice. The closer to college age, the more conservative the allocation. Right now, a typical conservative allocation might include 50% bonds, 30% money market funds, and 20% equities. Stable Value would be a great addition to these pre-mixes in lieu of unwrapped bond funds and money market funds, for the clear advantages it provides over both.

Anecdotally, 529 plan administrators and money managers tell us that plan participants as well as the financial advisors who are marketing the plans are clamoring for safe, principal-protected investments, creating excellent product development opportunities for Stable Value providers.

While individual company efforts have shaped the marketplace, the SVIA has helped raise the profile of Stable Value within the college savings market. Two years ago the SVIA board adopted an action plan for this market, which included:

- An illustrative, educational piece on Stable Value for college savings plans, available in print and at the SVIA website;
- Hosting a booth last year at the National Association of State Treasurers annual conference to raise Stable Value visibility;
- Raising awareness within our own industry through such articles as this in Stable Times, as well as giving college savings a prominent role at our annual conference.

These efforts, combined with those of individual members, have lifted Stable Value from anonymity into a highly sought-after asset class within 529 plans, for the same benefits as in the 401(k) world.

Looking ahead a couple of years, we can expect to see:

- Stable Value in all 50 states' 529 plans, and increasingly included in age-based portfolios;
- More efficient markets;
- Possible regulatory sand traps for 529 plans Ð President BushÕs Lifetime Savings Account proposal in particular (although most pundits believe implementation in its current form is remote).

It still remains to be seen how the regulatory and environmental factors play out, but the future for Stable Value in the 529 area continues to be bright.

Vicky Paradis Elected Chair

continued from page 1

JPMorganFlemingÕs US Fixed Income Group, where she heads the firm's Stable Value group and has client responsibility for conservative fixed income and Stable Value portfolios.

She is a frequent contributor to SVIAÕs Stable Times and co-chair of both SVIA's Performance Measurement Task Force and Media Team.

Vicky holds a BA from Cornell University and an MBA in finance and international business from Columbia University. She is also a CFA charterholder and licensed in Securities

Investors Flock to Stable Value

continued from page 1

Goerz, chief investment officer advice provider mPower, conc "The amount that we would re mend for a given individual to cate to Stable Value hasnÕt c he says. "ItÕs the same as it years ago."

Both mPower and Financi Engines advise participants in employer-sponsored retireme on how to allocate their retirer funds among different asset c and among available investme Ó529s within those asset cla Investors typically access the services via the Internet, altho some plan providers have be make advice available via call and even through face-to-face ings between plan participants financial advisors. In their earl incarnations, the online advice ices drew considerable criticis Stable Value professionals, w argued that the services didnÕ rately model the risk and re characteristics of Stable Value By the end of 2001, however, ing providers had made notab improvements to their Stable V modeling capabilities, and bot mPower and Financial Engine they havenÕt felt compelled t duce any significant changes then. Goerz acknowledges that mPower did make one change to its methodology last year, incorporating into its model an analysis of each fundÕs underlying exposure to credit risk.

While advice engines may not be cranking out bigger recommended allocations to Stable Value, many retirement plan investors are flocking to Stable Value funds anyway, dismayed by the losses chalked up by their equity investments. In 2001, the Standard & Poor 500 stock index posted a total return of Ð11.9%, a disappointing performance that it topped in 2002 by posting a total return of Ð22.1%. By contrast, the Hueler Analytics index of pooled Stable Value funds, which tracks the performance of some $59 billion in pooled Stable Value assets, earned 6.2% in 2001 and 5.6% in 2002.

If investors at large are flocking to Stable Value funds in spite of "stay the course" recommendations by advice providers, it may be because eight years after mPower debuted the first online advice serviceÑthe company was called the 401(k) Forum back thenÑonly about 5% of the nationÕs 60 million retirement plan investors have actually tried the services, estimates Neal Ringquist, mPowerÕs executive vice president. Investors who do use the services, adds Jones, are less likely to make dramatic changes in their retirement

continued on page 3

STABLE TIMES

First Quarter 2003

STABLE TIMES is a benefit of SVIA membership. Published by the Stable Value Investment Associati
located at 2121 K Street, NW; Suite 800; Washington, DC 20037; phone 202-261-6530; fax 202-2
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Investors Flock to Stable Value

continued from page

portfolios than investors who c
since those whoÕve receive
more likely to understand that
ing for retirement is a long-ter
undertaking generally ill serve
efforts to time the market.

Financial EnginesÕ Jones
that some investors who in ye
had indicated they had a high
ance for riskÑone of the facto
influences the advice they rec
have changed their profiles o
past year or so to accept less
That has led to recommendat
more diversified portfolios, inc
it would stand to reason, grea
cations to fixed-income invest
"Primarily, that seems to have
people who had a very heavy
tration of company stock in th
portfolios or a very heavy allo
to growth-oriented equity fund
Jones says. "They have back
from that and are now holding
diversified portfolios relative t
we saw three years ago, thou
would be rare to have seen s
dump all of their other investm
in favor of Stable Value."

That said, the investment
behavior of 401(k) participants
whole has been fairly dramati
late. According to data compil
the research and consulting fi
Hewitt Associates, approxima
of all transfers within the 401(
plans included in its Hewitt 40
Index last year flowed out of s
investments and into one of th
fixed-income categories: mon
ket funds, bond funds, or GIC
Value funds. Early in the year,
funds attracted most of the tra
fered assets. From May throu
August, bond funds and GIC/S
Value funds both drew large v
of transfered assets, but beginni
September GIC/Stable Value
began to attract the lionÕs sh
transfered assets. In the first m
of 2003, the disparity was eve
ing: 79.8% of all transfered assets
flowed into GIC/Stable Value
versus just 6.3% into money m
funds and 7.5% into bond fun
money that flowed into these
classes came from sales of e
funds of all types, but particul
large-cap US equity funds, wh
a negative outflow of 34.9%, a
company stock, which poste
tive outflow of 25.5%.

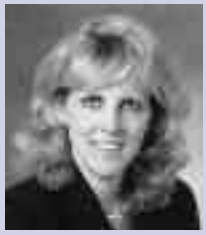
Transfer activity within 401
plans typically reflects the act
only a small portion of plan pa
pants, since the vast majority of
401(k) investors never move m
once itÕs in their plan. Howev
another measure of how inves
view Stable Value funds is the
to which they allocate new co
tions to them. Here, the Hewit
Index data indicates that in Ja
2003 investors allocated 22%
contributions to GIC/Stable Va
funds, up from 17.1% in Janua
2002 and 12.5% in January 2
contrast, contributions to US e
funds accounted for 29.4% of
contributions in January 2003
from 38% in January 2002 an
in January 2001.

The flow of new money in
Stable Value funds over the p
years, combined with the supe
returns being generated by St
Value relative to equity funds,
resulted in a dramatic up tick
percentage of retirement plan
held in Stable Value investme
ucts. According to the Hewitt
Index, GIC/Stable Value funds
accounted for 27.7% of 401(k)
in January 2003, up from 20.4
January 2002 and 17.4% in Janua
2001.

Going forward, both mOsbo
Goerz and Financial Engines
say the degree to which inves
cate money to Stable Value fu
could be impacted slightly by
President BushÕs proposal t
nate federal income taxes on
dividends, assuming that pro
adopted by Congress. If it is,
Jones, dividend-paying stocks
become more tax-efficient tha
were in the past which would
them more attractive for taxab
investment accounts. That be
case, investors who have size
investment holdings outside o
retirement plans, and who see
advice on those investments a
their retirement plan assets, c
recommendations to change w
assets they hold in their tax-d
retirement plan and which the
in their taxable accounts. Indir
Goerz adds, the tax cut could
side those pl

EditorÕs Corner

WendyCupps, PIMCO



When the editing committee gathered to discuss potential articles for this quar eÕs Stable Times, we thought at first that we might have trouble filling up enough pages But as always seems to be the case, we find selves with plenty of interesting and insightful industry news to fill this edition.

Given the recent uncertainty in the mar kets, and disappointing returns experienced by many investors, t retirement savings is appropriately receiving renewed focus and i attention these days. As such, there are many interesting develop we profile for you. We discuss several outstanding legislative pro affecting future retirement assets, including the Pension Security Bush savings proposals, and the proposal for eliminating the dou tion of dividends.

Given the valuable role that Stable Value plays in the retirem ings equation, we also have several things to report on the Stabl front. We have included the results of several reports on defined investor allocations and cashflow activity, all which point to positiv for Stable Value. And we discuss the growing use of both 529 pla arately Treasury Inflation Protected Securities (TIPS), and why both important implications for Stable Value investing.

As always, please let us know if you have a specific topic tha would like us to research and address in a future edition.

TIPSÑThe New Kids

continued from page 1

can investÕ capital by returning the inflation-adjusted face value to the investor at maturity. In addition, the TIPS coupon payment is calculated on the adjusted face value, ensuring that the stream of interest payments increases or decreases with the cost ing. While the face value and inter est payments would be adjusted downward if the CPI fell (that is the economy were to experience defla tion), the Treasury guarantees that

continued on page 4

TIPSÑThe New Kids

continued from page

the maturity value can never f
below the original face value.

The most recognized ben
holding TIPS is that they prov
inherent hedge against inflatio
thereby allowing investors to p
their purchasing power. This
inflation is why TIPS are often
"real return bonds". TIPS, like
Treasury bonds, are backed b
faith and credit of the US gov
and so are protected from def
risk. Other attractive characte
such as relatively low price vo
and low correlations to other ass
classes, led TIPS to be consid
an excellent portfolio diversific
tool and an alternative asset c
from other fixed income and e
securities.

Outstanding TIPS issuanc
grown to over $167 billion in r
value as of December 31, 200
According to the NY Fed, aver
TIPS secondary market tradin
ume exceeds $2 billion per da
has been growing. With the T
Department committed to futu
issuance of TIPS, it is expecte
the size and breadth of participation
of the US real return bond ma
will continue to grow. In addit
many countries such as Unite
Kingdom, Sweden, France, C
Australia, and New Zealand h
been active issuers of inflation
indexed bonds. This new glob
issuance has broadened the g
real return markets and has di
fied real return relative value o
tunities.

How Do TIPS Compar to Nominal Bonds?

Unlike nominal, or non-inf
tion-adjusted bonds, TIPS pro
sources of return: (1) a daily p
pal accrual that is based on th
and (2) fixed-rate coupon pay
that are fully indexed for inflat
it accrues on the adjusted fac
over time.

It works like this: Suppose
invest $1,000 in a new 10-yea
with a 2% coupon rate paid a
If inflation is 3% over the next
the face value will grow to $1,
reflecting the increase in cost
ing. Meanwhile the annual int
payment would be $20.60, or
coupon rate) of the adjusted p
pal. If inflation remains at 3%
each year, in the 10th year (a
inflation remains at 3%), the fi
interest payment would be $2
and the investor would receiv
$1,343.92 in adjusted face val
which would have an inflation-
adjusted value of $1,000.

As a result, TIPS, if held t
maturity, offer what is known
fixed "real" rate of returnÑthe
al return of an investment afte
tion is taken into account. A tr
tional bond, on the other hanc
a fixed "nominal" return. It ma
tains a fixed face value until m
ty, with no adjustments for infl
For example, if youÕre receiv
return on a traditional bond an
inflation is rising at 3%, your "
return is 2%. Unlike TIPS, the
real return the Treasury offers is n
fixed but falls or rises inversel
changes in the inflation rate. F
example, if inflation turns out
4%, the actual "real" return (e
for the nominal bond drops to
over its life.

Investors should be caref
when comparing TIPS against
lar maturity Treasuries, as real yi
do not move lockstep with cor
tional yields. Nominal yield ch
consist of three factors (1) rea
changes, (2) changes in inflati
expectations, and (3) changes
inflation risk premium. In cont
only changes in real yields infl
TIPS prices. As shown in Fig
the 2008 TIPS had low relativ
volatility to a comparable matu
treasury. Over the last two year
however, its volatility has begu
move more inline with that of
conventional counterpart. Fro
we can infer that inflation was
primary catalyst behind earlier
nal yield movements. In contr
recent yield movements have
driven more by changes in rea
est rates.

When estimating the sens
of TIPS to changes in nomina
est rates, one way for risk ma
to account for the observed m
real interest rate volatility and
than perfect correlation between TIPS
yields and nominal yields is to adjust
TIPS durations. Such TIPS durations
are known as "effective" durations.
They are extremely useful when com
bining TIPS and nominal fixed
income securities, as they describe
how much sensitivity to nominal rate
changes TIPS embody. In particular
the concept of effective duration
incorporates more accurately expect
ed price sensitivities, based both upon
previously observed and upon for
casted yield relationships between
Treasuries and TIPS, than naively
calculated formulaic durations based
simply on a TIPS price, coupon, and
maturity.

So how is such theory put to
work? To compare TIPS risk to that of
nominal bonds, an investor needs to
predict TIPS expected sensitivity to
changes in nominal interest rates.
This effective duration is calculated
by multiplying the standard mathe
matical duration by a "yield beta"
that has typically varied between 0.20
and 0.80. Unfortunately there is no
industry standard number to use for a
yield beta, rather it falls upon the
shoulders of risk managers to for
cast.

continued on page 5

Figure 1

TIPSÑThe New Kids

continued from page

Although TIPS are indexe inflation and have the full faith credit of the US Treasury backing them, they are not immune fro fluctuations in market value. the price of a traditional nomir bond fluctuates based on cha yields, the mathematics for TI essentially identical, except th operates on real yields and re tions rather than nominal yield nominal durations. In both ca the bondsÕ duration, applied change in rates (nominal rate case of the nominal bond, rea in the case of TIPS) is an exa dictor of price change.

How do TIPS Perform in Different Interest Rate Environments?

A key to understanding ho TIPS are valued is something the break-even rate of inflation which is calculated by subtrac TIPS yield from the nominal y a similar maturity conventiona Treasury. If the break-even rate one percent, for example, it that if the CPI rises by more than an average of one percent per an over the remaining life of the security the TIPS will outperform. If the CPI rises more slowly, the conventional Treasury will outperform.

Therefore, the break-even inflation rates generally reflect market expectations for future inflation (plus, theoretically, an inflation risk premium that compensates the holder of a conventional Treasury for the imprecision of such expectations). it is only an increase in inflation above what is expected that will result in TIPS outperforming similar maturity nominal bonds.

The chart below shows potential anticipated performance of TIPS in different interest rate environments. The best environment for TIPS is a falling interest rate environment that provides capital gains combined with high inflation that will increase income and principal. The worst environment is a rising interest rate environment that causes capital losses combined with low inflation that will reduce expected income.

Do TIPS Portfolios Compete with Stable Value?

As TIPS funds have gained popularity and are considered for inclusion in the fund line-up of many defined contribution plans, there has been increasing discussion as to whether TIPS funds compete with Stable Value funds. When we say "competing" funds, we do not mean simply an investment option that may cause the amount invested in the Stable Value fund to fall. A new investment option can have this effect.

"Competing funds" are generally considered to be funds with similar characteristics to Stable Value that may provide arbitrage opportunities for participants to transfer out of Stable Value when interest rates rise, posing risks for remaining Stable Value participants and the issuers of the book value contracts. Historically, money market and short-term bond funds have been considered competing funds. Protections, such as transfer restrictions (or equity washes) have been required to protect the book value contract issuers and the Stable Value participants.

Some book value providers suggest that TIPS should be considered competing funds. Their arguments generally center around the perceived similarities of TIPS funds with Stable Value and the potential that in an inflationary scenario the returns of TIPS funds may be more attractive than Stable Value funds which will lag behind market interest rate movements. This disengagement between yields could lead investors to transfer out of Stable Value and result in further lags (or even a decline) in the Stable Value crediting rate for participants who remain. This activity could increase the risk that book value providers could have (albeit limited) with participating wrap contracts) to absorb the market to book deficits.

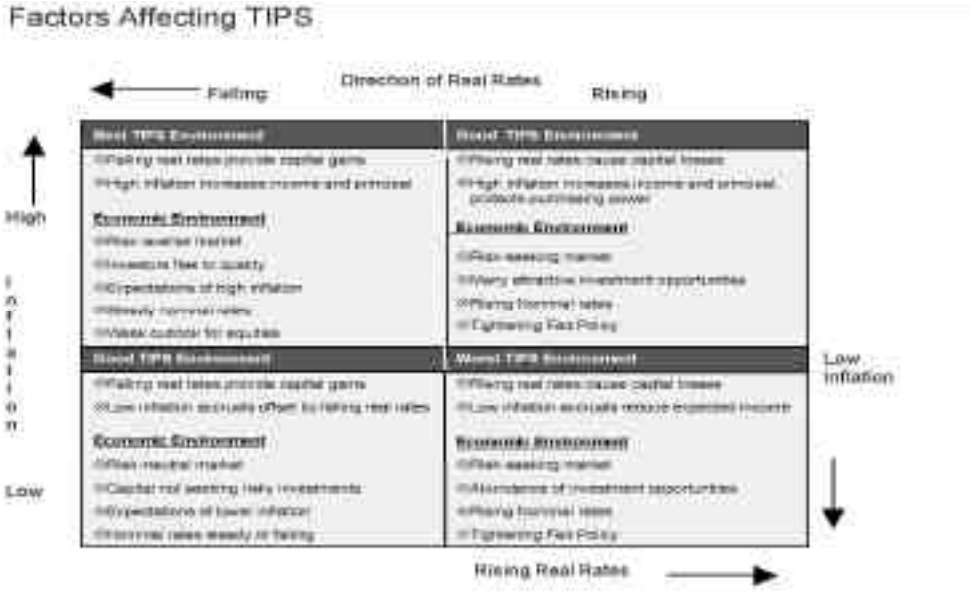
Other arguments, which suggest that TIPS should be considered competing funds, include:

- TIPS are a conservative investment option since they are issued by and have the full faith and backing of the US Government. Investors therefore will perceive them as "safe" funds and will not be able to fully understand the differences between TIPS and Stable Value funds.
- TIPS funds have less price volatility than nominal treasuries and other fixed income funds (with similar mathematical durations), making them appear similar to Stable Value funds. Ex-post TIPS effective durations have sometimes been similar to short term bond durations (which are considered competing), and have similar volatility and interest rate risk.
- TIPS preserve principal over their life which is especially valuable when inflation levels are unexpectedly high Ð a feature that leads them to appear to be similar to Stable Value.
- Like Stable Value, TIPS have low correlations to other asset classes and can be used to reduce overall portfolio volatility
- In their relatively short existence, TIPS have rarely generated negative returns over quarterly periods (coinciding with what participants see on their statements).

On the other hand, there are several arguments as to why TIPS should not be considered competing

continued on page 6

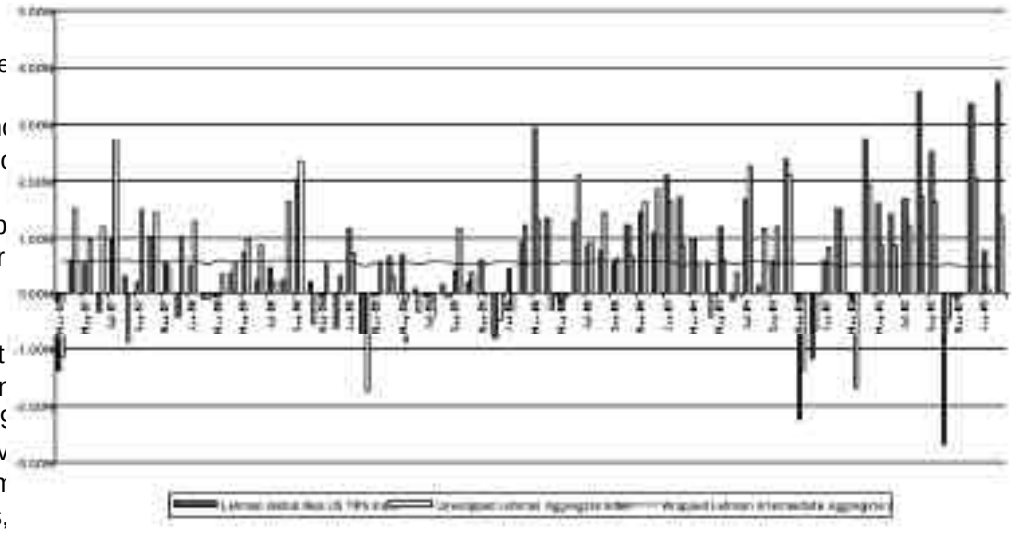
Figure 2



TIPSÑThe New Kids

continued from page

Figure 3



funds, and therefore should n require transfer limitations. S these include:

- TIPS are only designed to p a fixed real return over their remaining lifetime not ever period.
- TIPS have generated negat monthly and quarterly returr an example, since March 19 Lehman US TIPS Index hav ed a negative return in 18 m periods, 9 quarterly periods, six-month period. This compares negatively to stable value, w has protected principal throu periods.
- The return volatility of TIPS shown below) is materially h than a money market fund c Stable Value fund. As an ex the return volatility (as meas by standard deviation) of a Index compared to represer book value and Stable Valu indices is shown below:

In fact, the volatility of TIP has been similar to the volatili the Lehman Aggregate Bond and funds managed to this in generally not considered com funds. However, over this tim interest rates have generally d giving rise to the positive retu TIPS as well as various other income asset classes.

To further amplify this poir the bars in Figure 3 show the ly returns for the TIPS and Le Aggregate indices. As you ca numbers fluctuate significantly. For comparison, we have shown t monthly returns for a wrapped Lehman Intermediate Aggrega Index for the same time perio resented by the smooth line ir 3). This chart looks very simila the chart frequently used to sl benefits of wrapped versus ur bonds, illustrating the volatility unwrapped bonds and how th ence of a wrapper can smooth volatility. As with unwrapped nal bonds, the vast peaks and in the chart show that TIPS ar ject to price fluctuations as int rates change, and that particip investing in TIPS can lose mo

- TIPS fund typically are man versus benchmarks that hav long formulaic durations (typ ly 8 to 9 years). While the e duration to nominal rate cha will be somewhat lower thar because of the lower volatili real yields, the ex post effec duration of these benchmar almost always longer than th

	March 1997 through December 2002	
	Annualized Returns	Annualized Stnd. Dev.
Lehman Global Real US TIPS Index	7.75%	3.88%
Lehman Aggregate Index	8.03%	3.40%
Hueler Stable Value Index	6.23%	0.09%
Lipper Money Market Index	4.29%	0.45%

year duration threshold norr used to determine if nomina funds are considered comp

- While relative yield advanta give rise to true arbitrage op nities between money mark Stable Value funds, the sam true for TIPS funds in relatic Stable Value funds.

Yield is a good predictor o future expected returns for mo market and Stable Value fund have little or no price volatility result, participants should be ed for moving to the higher yi option. Similarly, to the exten term bond funds hold simila ments as those underlying Sta Value funds, an arbitrage oppo exists based on the presence accounting differences (marke versus book value accounting ments). A participant can exp rewarded by choosing the opti trades at a higher yield. Howe is not the case for unwrapped nal bonds or TIPS, which hav icantly more volatile returns re to Stable Value (as shown abo Funds with inherent price vola cannot be arbitraged based o As an example, even when TI performing well due to increas expectations for inflation, the ed yield of a TIPS fund may b falling, or may even be negati

Differences in TIPS and Stable Value fund returns are not determined sole ly by yield or accounting differences. TIPS returns are a function of com plex relationships relating to infla tion, real yields, real growth, and investment sentiment - and unlike yield and accounting differences, these differences cannot easily be arbitraged.

- Some TIPS funds can hold securi ties other than TIPS, which can further increase the return volatili ty of the funds. They may hold Corporates, Emerging Market, Non-US $, bonds, mortgages, pri vate placements, and below invest- ment grade securities. Some funds can also utilize leverage.
- Plan sponsors can influence how participants perceive TIPS funds. An accurate description of the risk and return characteristics of TIPS funds will clearly highlight the potential short-term volatility of TIPS funds. The features of infla tion protection versus principal protection can be clearly high lighted, and the potential for nega tive returns explained, to help to differentiate these options for the investor
- Requiring an equity wash may be confusing to participants who will then look at TIPS as a potential

continued on page 7

Pension Security Act Passes House Committee

Gina Mitchell, SVIA

The Education & the Workf Committee of the House p the Pension Security Act (1000) that strengthens and pr employer-provided defined co tion plans in a 29 to 19 vote. bill:

- ¥ Grants defined contribution investorsÕ new freedoms to their retirement savings with three years;
- ¥ Expands access to investme advice;
- ¥ Holds company insiders acc able for abuses during black periods; and
- ¥ Requires quarterly benefit s ments from defined contribu plans.

The comprehensive pensi protection bill was supported b President Bush. It was autho Education & the Workforce Committee Chairman John Bo (R-OH) and Employer-Employ Relations Subcommittee Chai Sam Johnson (R-TX) and co-s sored by Reps. Baron Hill (D-I Eleanor Holmes Norton (D-DC

The Committee fought off al Democratic amendments to approve the bill. The defeated amendments included:

- ¥ Requiring companies to give employees a choice betwee benefits of a cash balance p the previous pension plan.
- ¥ Requiring joint trusteeship o defined contribution plans.
- ¥ Requiring employees to be diversify employer stock hol after one year rather than HR1000Õs three years.
- ¥ Giving employers an exemp from the Employee Retirem Income Security ActÕs (ER fiduciary liability if they offer independent advice to 401(k ticipants.
- ¥ Notifying employees of executive stock sales.
- ¥ Bringing nonqualified defer compensation plans under E which would make them vul ble to the claims of creditors

"American workers deser security of knowing their savi be there for them when they r explains Chairman Boehner. bill could have made a real di for the workers at Enron and WorldCom. But pension laws simply outdated, and we have responsibility to change that," cludes Boehner

"Expanding worker acces quality investment advice is th important pension protection stresses Boehner. "This bill is mon sense way to encourage ers to provide investment adv benefit to their workers, and t includes strong protections to that they receive advice solely best interests."

"Too many Americans ha watched their retirement savi plummet. Today's action send strong signal that Congress w do all we can to help America reach their golden years finan secure," adds Employer-Empl Relations Subcommittee Sam Johnson.

The legislation is likely to in the House. Last April sim lation passed in the House by 263 vote. A companion bill is to be introduced this spring in Senat

New Chairs Named

A few changes have been made to the SVIA structure. First, many thanks to Pacific LifeÕs John Milberg for leading the SVIA Mission and Environment. The Task Force identified many impor before the Association under JohnÕs strong leadership and team

As Senior Vice President for Institutional Investing, JohnÕs re ties have evolved beyond Stable Value leading him to turn over t Force and its next stepsÑaddressing many of those issuesÑto Jo HancockÕs Wayne Gates.

This rotation has caused a shift among the Data and Resear Committee and its subgroups. AllstateÕs Steve Schafer has tak Chair of the Data and Research Committee. He will be ably assis Survey SubcommitteeÕs Co-Chairs: Kathleen Schillo, Hueler An Susan Olin, John Hancock. JPMorgan ChaseÕs Marc Magnoli w chairing the Data and ResearchÕs Asset Allocation Task Force.

A Role for Inflation Protected Securities in Stable Value Funds?

Greg Wilensky and Justin Egan, Alliance Capital
Wendy Cupps, PIMCO

As we have discussed in ou article, Inflation Protected Securities (IPS) offer a risk return tradeoff that is quite diff from nominal fixed income se Ð most notably the ability to o guaranteed (in the case of TIP backed by the full faith and cr the United States Governmen rate of return over the life of a ty. Given this unique charact and the "real" nature of the lia faced by most 401(k) investor role, if any, can IPS play in Sta Value funds?

IPS could be used in Stab Value on either an opportunist strategic basis. Below, we wil ate each approach in turn:

Opportunistic Case

IPS provide an active mar with an additional tool to use i adding value in a Stable Value lio.

A manager may derive va from investing in IPS when the appear undervalued relative t securities available for invest IPS may be considered attrac manager either expects real r fall, or believes that the break

inflation rate is too low. In both case IPS stand to profit. Hence, we believ that an opportunistic allocation to IPS, when the manager deems they are attractive, is beneficial in a Stab Value portfolio.

The issues surrounding the opportunistic use of IPS in Stable Value funds are not notably different than the issues for many other secu ties with less stable durations like MBS, non-dollar securities and high yield bonds. Since the effective dur tions may change frequently/dramat ically, the overall portfolio duration can be affected and must carefully b managed.

Including a modest amount of IPS in a Stable Value fund introduce some mild complications (discussed below) in the computation of the crediting rate if a portfolio-based crediting rate formula is used. If a portfolio-based crediting rate formula is used (i.e., the yield and duration o the portfolio are used as inputs into the crediting rate), a determination needs to be made on how the yield and duration for the IPS will be cal culated. For the yield, will the real yield be used? Or will it be grossed

continued on page 8

TIPSÑThe New Kids

continued from page 6

substitute for, rather than comple ment to, a Stable Value option.

TIPS funds continue to be con sidered for defined contribution plans, and it seems they are very pop ular selections by employees who can access them through a brokerage "window" option in the plan.

As such, there will clearly be more discussion of these argumen

Inflation Protected Securities

continued from page

for inflation? If so, what inflati last monthÕs, a short term for a longer term forecast? For d will the mathematical duration used or will it be converted to effective duration using the hi or estimated relative yield vol While these issues require-so tional consideration, they can caused by changing inflation e be addressed. Alternatively, a indexed-based crediting rate f (which we recommend) avoid issues completely and is an a ate for a modest allocation on opportunistic basis.

Strategic Case

While there seems to be a case for opportunistic use of I Stable Value portfolio, the stra case for IPS in Stable Value i clear. For our analysis of a st allocation to IPS, we will assu entire Stable Value fund will b invested in IPS. While a wrap portfolio could easily represen fraction of a Stable Value fund assets, this assumption will si the discussion.[1]

While an IPS will have a g anteed real rate of return over of the security, itÕs nominal re will vary over the life of the se and the life time guarantee impose very few restrictions on the pa returns. These volatility issue amplified further in the contex IPS portfolio managed on a co duration basis. By wrapping a con stant duration IPS portfolio, we can smooth out their substantial retur volatility in a similar fashion to wrapping nominal bonds.

Since the long-term real returns on an IPS portfolio will be more sta ble than the long-term real returns on a nominal portfolio, a wrapped IPS portfolio would do a better job of reducing swings in participantsÕ real purchasing power than a wrapped nominal portfolio over the long run. (Note: over shorter periods, the differ ences will be much more modest because the volatility reduction from wrapping the portfolios will be insig important). For all Stable Val funds, the cumulative returns to all investors must equalÑin absence of any payments to/f wrapper providersÑthe cumul returns on the underlying inve ments.

With a properly structured wrapper contract, the crediting for a wrapped IPS portfolio ca more responsive than the typi Stable Value fund (holding du constant) to changes in intere caused by changing inflation e tations. This is because IPS v not drop in value (or would dr less than nominal bonds) if int rates were to rise sharply bec inflation expectations increase stering the crediting rate so it rising market rates more quick a regular Stable Value portfoli (That is, since the IPS portfoli not drop in value due to incre inflation expectations, there is to amortize into the crediting r offset the increasing nominal On the other hand, the lag as with changes in real interest r would be similar to that of a n Stable Value fund.) Such dyn could further reduce the odds Stable Value fundÕs crediting would lag behind money mark returns in a sharply rising inter rate scenario. In other words wrapped IPS portfolio allows i to take advantage of the high cated inflation risk premium h expected returns typically offe extending out the yield curve money market securities with pronounced lag affect. The im tracking will result only if the is regarding the crediting rate fo discussed above are properly addressed.

While the improvement in iting rate responsiveness coul attractive, there is a substanti back to a strategic allocation t in Stable Value funds. The lo expected return for IPS can b the return on nominal bonds.

The Inflation Risk Premium

Since the owners of IPS a insulated from the real return ity caused by investorsÕ inabi accurately predict inflation, the should not be entitled to the "i tion risk premium" that is theo cally embedded in the yields o by nominal bonds. This mean in theory over the long run an IP portfolio should have a lower both nominal and real returns

Fortunately, for our investors in IPS, this theoretic has generally not manifested the IPS market. For most of t existence, the break-even infl rate has been at or below the inflation rates being predicted most economists. Therefore, reluctant to recommend a strategic allocation to this sector at the

[1] For example, if only 25% of a Stable Value fund is invested in wrapped IPS, 25% of both the benefits and costs discussed b

[2] If you have any doubt that the typical upward slope in nominal interest rates does not hold in the "real" space, consider that offer negative real returns (there is not much disagreement about inflation expectations for the next month or so) while 5, 10 rently sport real yields of .9%, 2.0% and 2.6% respectively

been 0 or even negative (i.e., investors have not paid a premium for inflation protection, and have actually been paid to take less risk).

Limited Scope of Investments

Unfortunately, the second cause of return drag is very much a real world issue. Currently, with respect to USD denominated investments, the investable universe of IPS is limited to the 10 TIPS plus a very small group of other securities (most notably an Inflation Protect Security issued by the Tennessee Valley Authority). Therefore, in the absence of the use of derivative and/or lever age strategies, any IPS portfolio will be giving up the opportunity to ear compensation for taking on credit or structure/option risk.

Conclusion

Given significant relative value swings that have occurred between IPS and nominal bonds, a successful manager can clearly add value using IPS on an opportunistic basis. While we are excited by the prospect of incorporating the unique characteris tics of IPS in Stable Value on a strate gic basis, currently the limited diver sity of issuers and securities as well as their limited track record makes us reluctant to recommend a strategic allocation to this sector at the

Positive Stable Value Cash Flow Trend in 2002

Kathleen Schillo, Hueler Companies

The Stable Value separate account market segment which is represented by the FIRSTSource mark the average cash flow for three out of the four quarters in 2002 was positive. The average was high 2002 with the positive trend remaining throughout the end of the year

FIRSTSource Market Data:	4th Qtr 2002	3rd Qtr 2002	2nd Qtr 2002	1st Qtr 2002	4th Qtr 2001	3rd Qtr 2001	2nd Qtr 2001	1st Qtr 2001	4th Qtr 2000
95%	9.67%	10.26%	6.13%	5.06%	4.15%	9.62%	3.46%	10.08%	6.63%
75%	2.84%	5.66%	2.59%	1.27%	0.45%	4.65%	0.41%	5.15%	0.91%
Average	2.01%	3.45%	1.09%	-0.24%	-0.81%	2.80%	-0.81%	2.67%	-0.73%
25%	0.20%	0.90%	-0.42%	-1.81%	-2.43%	0.66%	-2.51%	0.28%	-2.58%
5%	-1.61%	-1.18%	-3.29%	-5.24%	-4.68%	-2.17%	-4.92%	-4.93%	-8.07%

FIRSTSource market reports encompasses approximately 300 plans across 15 investment manager in plan assets and $95 billion in Stable Value assets.

2001 EBRI/ICI 401(k) Data Show Small Changes

Gina Mitchell, SVIA

A more volatile and declining stock market did little to ch 401(k) allocations in 2001 according to a new report fro Employee Benefit Research I and Investment Company Inst The repo 401(k) Plan Asset Allocation, Account Balances Loan Activity in 200 had changed over the past si with 70% of 401(k) assets inv directly or indirectly in equity

However, the devil is in th details. Small changes were 2001. 401(k) investors on av allocated more to conservativ ments. Allocations to Stable V

investments rose to 14% follo bonds at 8% and money mark at 5%. Additionally, equity fur (48%) and company stock (17 declined slightly in 2001. Allo to balanced funds remained fl 8%.

EBRI found that the avera account balance of participant declined by 4% for participant consistently had balances thro the databaseÕs six-year life. V said, the average account bal year-end for all participants w 1 ticipated throughout the six-ye period was $43,215. This dec considerably less than US equ

Average Account Balances Among 401(k) Participants Present in 1999, 2000 & 2001[1], by Age[2]

	Average Account Balances (Dollars)		
Age	1999	2000	2001
20s	$ 8,842	$ 11,235	$12,993
30s	33,055	34,757	34,884
40s	64,055	64,849	62,900
50s	100,410	98,099	92,468
60s	127,136	119,743	108,958
All	61,116	61,125	58,785

	Change in Average Account Balance (Percentage)		
Age	1999 to 2000	2000 to 2001	1999 to 2001
20s	27.1%	15.6%	47.0%
30s	5.2	.4	5.5
40s	1.2	-.3	-1.8
50s	-2.3	-5.7	-7.9
60s	-5.8	-9.	-14.3
All	0.01	-3.8	-3.8

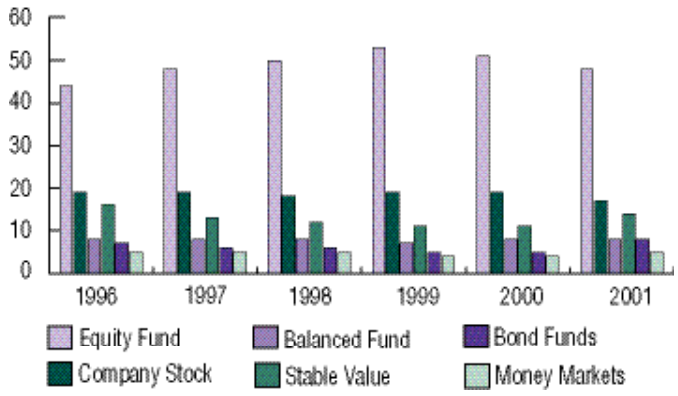
1 Sample of 6.9 million participants with account balances at year-e year

2 Age cohort based on participantÕs age at year-end 1999.

Source: Tabulations from EBRI/ICI Participant-Directed Retireme Collection Project.

401(k) Plan Average Asset Allocation, 1996-200

(Percentage of Total Assets)



Source: Tabulations from EBRI/ICI Participant-Directed Re Collection Project.

decline of 12% for 2001. Part may have faired better than e since they made contributions that same period of time.

EBRI found the average account balance for 2001 was $58,785 for participants who h 401(k) balance at year-end re of their participation over the s life of the survey. Lastly, EBR that as age and participation i es, so do 401(k) balances. Tl table provides highlights of ac balances.

As in previous years, the found considerable difference asset allocation based on the

the participants. Younger investors allocated more to stocks and less to conservative investments. As age increases, EBRI found an inverse relation to equity investments and an increasing allocation to conservative investments. Allocations based on age are highlighted below

The EBRI/ICI report tracks the behavior of about a third of all active 401(k) participantsÑor 14.6 million participants holding more than $632 billion in assets. For more informa tion or a copy of the EBRI Report, please go to:

http://www.ebri.org/pdfs/0303ib.pdf or EBRIÕs March 2003 Issue Brief.

Average Asset Allocation of 401(k) Accounts, by Participant Age, 2002

(Percentage of Account Balances)

Age	Equity Funds	Balanced Funds	Bond Funds	Money Market Funds	StableValue Funds	Company Stock	Other	Unknown	Total*
20s	58.6	8.7	6.1	5.6	6.1	13.8	.06	.04	100
30s	58.	8.	5.7	4.2	6.5	16.5	.8	.3	100
40s	51.6	8.1	6.5	4.7	9.8	18.1	.9	.3	100
50s	45.1	8.	7.9	5.5	14.8	17.3	.9	.3	100
60s	36.2	7.8	10.7	6.3	24	14	.8	.2	100
All	47.7	8.	7.6	5.2	13.6	16.8	.8	.3	100

*Row percentages may not add to 100 percent because of rounding.

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

Scrambled Eggs: Bush Savings Proposals Start Discussions

Gina Mitchell, SVIA

For many in the retirement savings community, when it comes to President BushÕs savings proposals, the question may be how do you like those eggs? And like the answer is probably without the shell. However, the Administration served some shell to members of the retirement network by taking an approach that did not build upon most existing saving structures.

The Administration proposes three savings vehicles for individuals to make after tax contributions to: Lifetime Savings Accounts (LSA) would permit up to $7,500 per year to be saved for any purpose could be withdrawn and used at the discretion of the saver without penalty. The LSAs would fold in the current or medical saving accounts, the Coverdell Education Savings Accounts and 529 educational savings plans.

The proposal would allow for a version of previous savings vehicles into a LSA until 2004. Accounts and balances would be continued and grow forward after that date. The AdministrationÕs proposal allows the previous savings vehicles and the new LSA to co-exist. However, some may prefer the flexibility of the new LSA to the older vehicles.

Retirement Savings Accounts (RSA) would permit up to $7,500 per year to be saved for retirement. RSAs would replace traditional and Roth Individual Retirement Accounts (IRAs). Like IRAs, the new RSA savings vehicle could only be used for retirement. Further, RSA earnings would be tax-free like Roth IRAs and distributions also would be tax-free after retirement age 58 or in the case of disability or death.

Traditional IRAs can be converted into RSA or continued. However, new contributions would not be permitted in traditional IRAs. Current balances could continue in the tax-deferred under current rules until retirement, disability, or death. Conversions from traditional IRAs would be subject to tax since contributions are based on after tax contributions.

Employer Retirement Savings Accounts (ERSAs) would permit up to $12,000 per year to be saved for retirement. ERSAs would replace the assortment of defined contribution plans that have developed over the years: 401(k), 403(b), SARSEPs and SIMPLE plans. Defined benefit plans and other plans that do not permit employee contributions would remain unchanged.

The Treasury DepartmentÕs Assistant Secretary for Tax Policy Pam Olson asserts that ERSAs will all the benefits of a defined contribution plan to both employer and employee without the baggage and complexity. ERSAs attempts to eliminate the downside of defined contribution plans by: simplifying the rules, repealing top heavy rules, streamlining discrimination tests and proposing a new safe harbor.

Olson says that ERSA simplification will encourage small businesses to sponsor more plans and that the current tax codeÕs complexity has had pension coverage stuck at 50%. She adds that ERSAs would provide a big incentive: reduced plan costs for small employers to establish an ERSA, which will contribute to increased pension coverage.

Some disagree with the proposal. Senator Ted Kennedy (D-MA) calls the AdministrationÕs proposal, "the greatest redistribution of tax preferences from working families to the wealthiest families." Others charge the Administration plan will shift current savings into these new tax-advantaged vehicles providing some $15 billion revenue in the early years (as individuals move from tax-deferred accounts into the new after-tax LSA and RSA accounts) to fund the PresidentÕs budget proposal.

Others say that LSAs and RSAs will create a disincentive for small business to establish any type of defined contribution plan because their generous contribution limits to $30,000 a year for a married business owner and his or her spouse. Some claim the lure of the LSA unrestricted savings will motivate individuals to move their retirement savings and other tax-advantaged savings like 529 and MSA plans into these vehicles since they provide more flexibility on the spending side. Others claim that eliminating rules that limit executives pension contributions based on participation of lower-paid workers will result in lower participation and savings by the same lower-paid workers.

Yet others claim that defined contribution plans like the ERSA will retain their allure because of employer matching contributions and the additional benefits employer plans bring such as a professional fiduciary and the buying power of big business. They say the economics of an employer deduction for savings contributions is what gets some to save.

What is a given, according to a March 17, 2003 article in Pensions &

For more on the Administration's economic growth package and its a on pensions see "Eliminating the Double Taxation of Dividends" on page 12.

Investments, is that pensions have historically provided only 24% of retirement income and Social Security will not be making up the balance. I believe that employer-provided plans need to part of the solution for individual savers.

Employer provided plans provide assurances that cannot be underestimated or obtained on an individual basis, which is the power of the employer. Employers bring to the table cost-effective saving vehicles as a result of having the buying power of big numbers, a broad and effective array of risk-diverse and screened investment options. ERISA's requirement that decisions be made for the exclusive benefit of plan participants and beneficiaries, matching contributions, and the ease of savings through payroll deductions.

That's a lot for investors to give up. Let's make sure employer-provided defined contribution plans remain not only a solid option for individuals to save for retirement but a preferred and privileged vehicle. And individuals are privileged, if they are offered and fully participate in an employer provided defined contribution plan.

Increase for 2002 Stable Value Sales

Stable Value and funding agreement assets grew to $419 billion found a joint Stable Value Investment Association-LIMRA survey. The covered 33 Stable Value service providers. Companies reported $30 in Stable Value assets and $110 billion in funding agreement assets f

Sales of Stable Value and funding agreement products were mixed ing 2002. Compared with the same period in 2001, Stable Value sales increased 21%, while funding agreements decreased 4%.

The average new Stable Value contract in 2002 was $29.9 million average funding agreement contract in 2002 was $39.9 million.

Global sales captured 31% of total funding agreement sales for 2

Sales to short-term investment funds and other markets accounted fo and 15%, respectively. Sales to municipal markets accounted for 14% sales to foreign markets represented the remaining 12%.