STABLE TIMES

The quarterly publication of the Stable Value Investment Association Volume 7, Issue 2 • Second Quarter 2003

IN THIS ISSUE

Stable Value Benchmarking: All Over the Map 1
Victoria M. Paradis, JPMorgan Fleming Asset Management

Credit Rating Pressure Effects on Stable Value Issuers 1
R. Kendall "Tex" Green, Bank of America

Processing Stable Value Funds: How DTCC's Defined Contribution Service Makes it Easy 1
Paul Hart, Mutual Fund Services, The Depository Trust & Clearing Corporation

The Spirit of HR 1776: Save! 4
Gina Mitchell, SVIA

What You, Your Parents, and Your Kids Have In Common: Money Worries GAO Studies Generational Equity of Wealth and Future Income 5
Gina Mitchell, SVIA

529 Plans and Stable Value 7
Gina Mitchell, SVIA

Survey Finds Division on Economic Stimulus Package 7
Gina Mitchell, SVIA

House Debates Advice Legislation, Bill Passes & Waits for Senate Action 8
Gina Mitchell, SVIA

A Look Back in Time… Separate Account vs. Pooled Fund Index Returns 8
Kathleen Schillo, Hueler Analytics

the Bear,
the Boomers,
and Stable Value

Has the Benchmark for Retirement Security Changed from Maximizing Returns to Avoiding Ruin?

October 14-16, 2003
The Ritz Carlton
1150 22nd Street, NW
Washington, DC 20037

Stable Value Benchmarking:

All Over the Map

By Victoria M. Paradis, CFA, JPMorgan Fleming Asset Management

The Stable Value Investment Association (SVIA) sponsored a Stable Value Fund benchmarking survey in the second quarter of 2003. Respondents totaled 35. They included 26 Stable Value managers, four plan sponsors that have an externally-managed Stable Value fund, and five plan sponsors who manage their fund internally.

The survey focused on three key questions regarding their approach to Stable Value benchmarking:

1) How do you evaluate book value returns for Stable Value funds?
2) How do you evaluate the Fund's investment performance?
3) What investment benchmark do you use?

continued on page 3

Credit Rating Pressure

Effects on Stable Value Issuers

By R. Kendall "Tex" Green, Bank of America

The public spotlight trained on the securities industry in the wake of several high profile bankruptcies over the past couple of years – Enron, WorldCom, et al. – has perhaps burned most hotly on the necks of the major credit ratings agencies. The rapidity with which some of these issuers' debt fell from investment grade to default has led to criticism of the ratings agencies for their apparent failure to give investors advance notice of impending doom. This criticism has appeared both in market commentaries and in SEC hearings convened for the sole purpose of assessing the current state of the ratings business. This has a number of implications for the Stable Value industry.

One consequence of the criticism is the shift towards more conservative actions and reactions on the part of the ratings agencies. While there have been no formal public statements of revisions to their ratings-assignment methods, a conservative shift can be inferred from a couple of

continued on page 4

Processing Stable Value Funds:

How DTCC's Defined Contribution Service Makes it Easy

By Paul Hart, Director, Mutual Fund Services, The Depository Trust & Clearing Corporation

The Depository Trust & Clearing Corporation's has an understated role in the financial markets, a tribute to how well it does its job—providing the infrastructure for trading that makes U.S. financial markets the model for the world. DTCC has taken this knowledge and applied it to both mutual funds and defined contribution plans.

Since the 1980s, when DTCC's subsidiary, National Securities Clearing Corporation (NSCC) extended its services to the mutual fund community, the organization has continued to help grow the fund industry. It created a network of connectivity among virtually all broker/dealers, banks, fund companies, third-party administrators, major insurance carriers and financial intermediaries. And it created services such as the industry standard for transaction processing - Fund/SERV® - and Defined Contribution Clearance & Settlement (DCC&S).

Defined Contribution Clearance & Settlement—What It Is

For defined contribution business partners – fund companies, trustees, and third-party administrators – DCC&S offers a unique, fully-automated, centralized servicing hub for processing defined contribution plan orders, whether they are mutual funds, Stable Value funds, collective investment trusts or separate accounts.

Since its introduction in 1997, DTCC has helped eliminate a complex web of "spaghetti-type" connections for firms using the service. In addition, DCC&S has standardized the order flow through its pipeline, moving information quickly, reducing operating costs, and simplifying the settlement process by calculating

continued on page 2

Processing Stable Value Funds

continued from page 1

one single money settlement figure for each participant daily.

What Users Say about DCC&S

For firms like MetLife, one of the largest national providers of Stable Value funds with $18 billion in Stable Value assets, a service such as DCC&S has become a critical component of its business. MetLife uses DCC&S for its Met Managed GIC product and plans an ongoing migration of its Stable Value assets onto DCC&S. Ben Gorton, MetLife managing director, Stable Value Investments, explains, "Most 401(k) providers, especially TPAs that want to access different funds, have to be able to link to Fund/SERV, regardless of what platform they are on. For MetLife, it's critically important to our business that we use the DCC&S platform, and that our business partners do, as well. We couldn't have built such a large business otherwise. The intense labor that a manual environment requires, plus the errors you encounter in transmitting information by fax or phone, would have slowed us down."

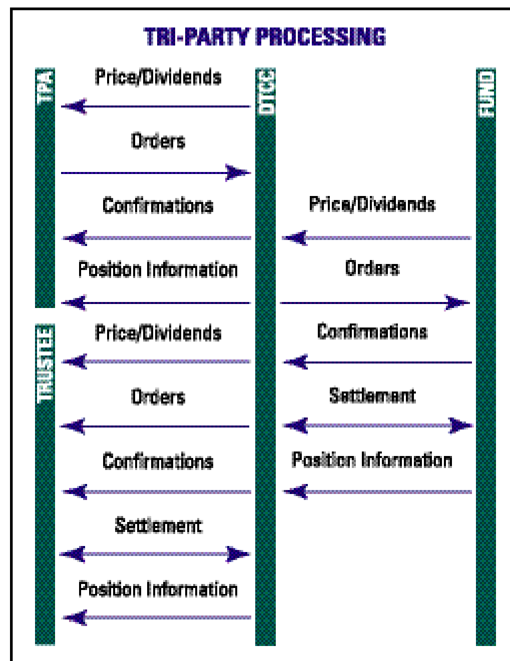
Galliard Capital Management, a subsidiary of Wells Fargo & Company and another leading Stable Value manager, has been using DCC&S for the past two years. "We've found the service to be a very efficient way of communicating between our record-keepers and Wells Fargo. Trade communications are done on-line, and the settlement is completed through a single wire that includes all our fund transactions," says Leela Scattum, a principal with Galliard.

Before becoming a member of NSCC, Galliard/Wells Fargo would handle its Stable Value trade processing manually. "A record keeper trading with a fund would fax an order to Wells Fargo and the money would be transferred by wire. We were exchanging different wires with different parties every day. It was not cost efficient," she notes.

How DCC&S Works

DCC&S uses three DTCC Mutual Fund Services to move a defined contribution trade through all the steps leading to a smooth, problem-free conclusion. It combines the order entry, confirmation and registration capabilities of Fund/SERV with the account maintenance and customer account record-keeping capabilities of Networking, and the NAV calculations (and other underlying security data) of Mutual Fund Profile Service.

In a typical DCC&S process,



Mutual Fund Profile Service receives from fund companies the daily NAVs of each fund, and sends that information, along with the rates, to record keepers and trustees. The record keeper calculates the orders for each fund and transmits the orders through Fund/SERV. After a basic format and file check, Fund/SERV transmits the orders to the fund companies and the trustees. Fund companies then confirm or reject the orders, and, if confirmed, the transactions are set up for settlement.

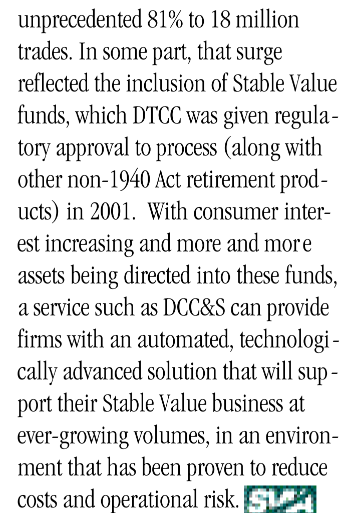
On settlement day, trustees and funds are provided with a net settlement figure and a summary of all purchases and redemptions. NSCC then debits or credits each trustee and fund company with a single net settlement via Fed Funds for all confirmed trades. TPAs can also transmit data to firms acting as clearing hubs, and they will be directly responsible for settlement of trades with DTCC.

In the final step, a fund company submits updated account balance information through Networking, and this information is then transmitted to the trustee and the TPA.

In a situation where a firm acts as both record-keeper and trustee, the role of TPA is eliminated.

Usage Continues to Grow

Over the last five years, DCC&S has experienced significant growth in the number of users and in the volume of defined contribution transactions being processed through the service. This was most dramatically apparent in 2002, when volume increased an



unprecedented 81% to 18 million trades. In some part, that surge reflected the inclusion of Stable Value funds, which DTCC was given regulatory approval to process (along with other non-1940 Act retirement products) in 2001. With consumer interest increasing and more and more assets being directed into these funds, a service such as DCC&S can provide firms with an automated, technologically advanced solution that will support their Stable Value business at ever-growing volumes, in an environment that has been proven to reduce costs and operational risk. SVIA

DTCC is an industry-owned utility that was formed originally by the NYSE, the American Stock Exchange and the NASD. Operating on a cost basis, DTCC's subsidiaries serve as a post-trade clearinghouse for virtually all equity and fixed income trades, including corporate and municipal bonds and government and mortgage-backed securities. DTCC is also the leading processor of mutual fund and insurance products; and its depository subsidiary provides custody and asset servicing for more than two million securities issues from the U.S. and more than 100 other countries.

STABLE TIMES

Second Quarter 2003

STABLE TIMES is a benefit of SVIA membership. Published by the Stable Value Investment Association located at 2121 K Street, NW; Suite 800; Washington, DC 20037; phone 202-261-6530; fax 202-261-6527; www.stablevalue.org

Co-Editors:

Wendy Cupps	PIMCO (wendy.cupps@pimco.com)
Greg Wilensky	Alliance Capital Management Corporation (greg_wilensky@acml.com)

Editorial Board:

Jo Anne Davis	State Street Global Advisors (jo_anne_davis@ssga.com)
Charlene Galt	MassMutual Financial Group (cgalt@massmutual.com)
Aruna Hobbs	AEGON Institutional Markets (ahobbs@aegonusa.com)
Steve LeLaurin	INVESCO Institutional (steve_lelaurin@invesco.com)
Victoria Paradis	JPMorgan Fleming Asset Management (victoria.m.paradis@jpmorganfleming.com)
Kathleen Schillo	Hueler Companies (kathleens@hueler.com)
Robert Whiteford	Bank of America (robert.whiteford@bankofamerica.com)

Stable Value Benchmarking

continued from page 1

Evaluating Book Value Returns

To evaluate the "Book Value" or stabilized returns that fund participants earn, most respondents set some form of a book value-based benchmark. A cash-based benchmark received the most responses (53 percent), as illustrated in Chart 1. demonstrated in Chart 2. Slightly more than half of respondents (53 percent) believe that market value performance is the best way to report Stable Value investment performance. Yet, a significant 47 percent believes that book value returns remain most appropriate. Of the 47 percent that prefer to report book value returns, 8 percent will present market value performance at the request of their clients.

There are essentially two schools of thought on evaluating Stable Value Fund performance:

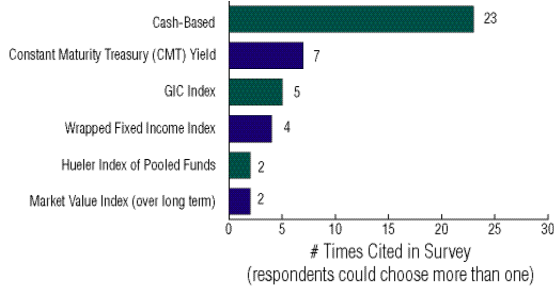


Chart 1. Book Value Benchmarks Used for Stable Value Funds

Cash-based benchmarks include Treasury Bills, Money Market Funds, or LIBOR benchmarks – flat or plus a spread. The benefits often cited for a cash-based benchmark include familiarity and ease of understanding to the participant audience. Cash-based benchmarks also reflect the closest alternative to Stable Value that most participants could invest in, outside of their defined contribution plan.

Evaluating Fund Performance

The next issue distinguished between investment performance and fund performance. What's the point in making that distinction? The underlying assets in a Stable Value fund have a market value or fair value that is different from the stabilized book value earned by participants. The question at hand is whether the underlying marked-to-market returns are relevant for Stable Value performance reporting. The industry remains split on this issue as

The "Book Value" camp believes that participants earn book value returns, so book value is the best measure of a fund's success. Market value reporting adds unnecessary complexity.

The "Dual Reporting" camp favors book value reporting for the participant audience and market value reporting for the plan sponsor or consultant audience. The rationale for dual reporting hinges on the premise that book value returns prevent meaningful reporting on a manager's investment decision-making. The smoothing mechanism behind book value returns masks timely evaluation of investment decisions. Book value returns are also materially affected by the timing and level of interest rates when external cash flows occur. As a result, it is not possible to discern the cause-and-effect behind book value returns. In contrast, marked-to-market returns isolate and accurately measure the results of manager investment decisions and allow for simple comparison and performance attribution against a market value benchmark. This enables meaningful evaluation of manager decision-making, including useful performance attribution.

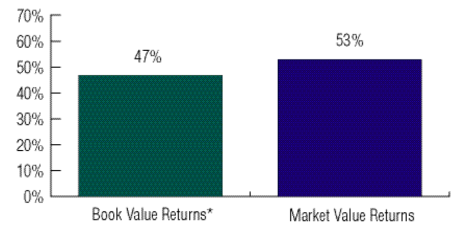


Chart 2. View of Best Way toEvaluate Stable Value Investment Performance

Market Value Benchmarks

For those respondents that use a market value benchmark, the survey found that most use a single, standard fixed income benchmark. This approach has the benefit of enabling manager comparisons and performance evaluation methods akin to monitoring defined benefit fixed income managers. Yet custom benchmarks are also common, and are intended to reflect unique client and Stable Value characteristics. Another approach is to establish standard market indices for segments of a fund, but not necessarily a market benchmark at the total fund level. These approaches are demonstrated in Chart 3.

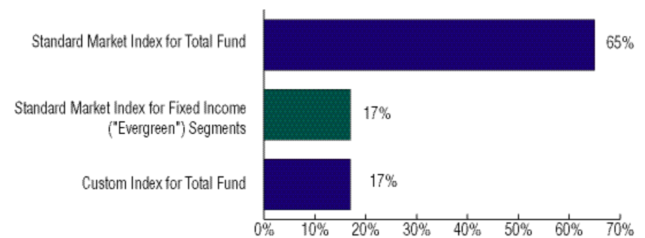


Chart 3. Market Benchmark Used by Those Who Evaluate Market Value Returns

Finally, the standard market indices used vary widely – from single sector to multi-sector benchmarks, from short term to broad market durations. The risk and return characteristics of the most commonly cited benchmarks are illustrated in Chart 4.

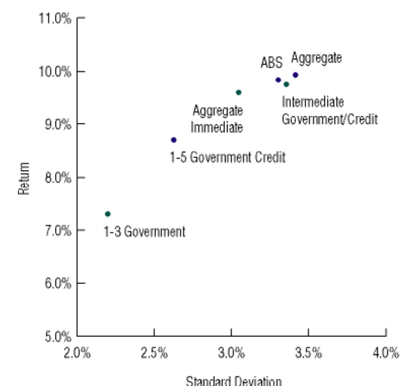
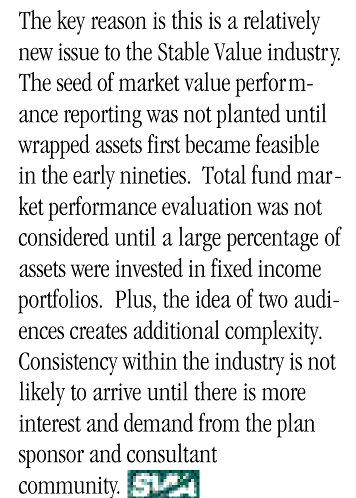


Chart 4. Comparison of Lehman Indices April 2000 to March 2003

Variety of Responses

Why are industry responses so varied, particularly as it relates to the underlying portfolio's investment performance?



The key reason is this is a relatively new issue to the Stable Value industry. The seed of market value performance reporting was not planted until wrapped assets first became feasible in the early nineties. Total fund market performance evaluation was not considered until a large percentage of assets were invested in fixed income portfolios. Plus, the idea of two audiences creates additional complexity. Consistency within the industry is not likely to arrive until there is more interest and demand from the plan sponsor and consultant community.

Credit Ratings Agency

continued from page 1

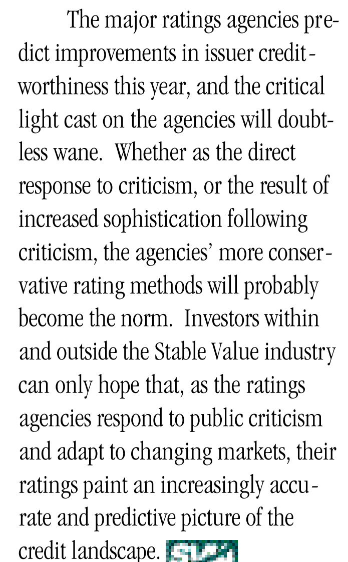
new developments. One is the treatment of ratings triggers – contractual clauses requiring the restructuring or accelerated repayment of debt or the posting of collateral in the event of specified rating actions. Following the bankruptcy of Enron – whose implosion was partly due to the cascading liquidity strain that can follow the activation of a ratings trigger – the ratings agencies have begun to assess the weight triggers add to a company's debt, even refusing to rate some new issues that have triggers. This wariness is not limited to the ratings agencies.

Another area in which ratings agencies may be becoming more conservative is in their initial ratings and subsequent rating revisions. An indication of a conservative shift is the number of downgrade ratings in 2002. There were a record number of ratings downgrades last year. Standard & Poor's, for example, downgraded 1123 issuers globally in 2002, compared to 266 upgrades, for a ratio of 4.22. During the same period, the number of defaults actually fell compared to 2001, and is expected to decline further in 2003. However, the ratio of downgrades to upgrades for the first quarter of 2003 was 4.65, an increase over that for 2002. The combination of a decrease in the number of defaults and an increase in the number of downgrades suggests that ratings agencies may be more sensitive to negative pressures and quicker to effect downgrade. The ratings agencies' increased responsiveness, even if only with regard to downgrades (nothing suggests ratings agencies have become quicker to make upward rating revisions), may benefit asset managers by giving an early warning sign to issues that may be in trouble. At the same time, though, given the overall downward migration of credit ratings, Stable Value portfolio managers will find fewer issues that meet plan sponsors' high-quality investment guidelines.

Plan sponsors themselves are affected by criticism of the ratings agencies. Not only has the number of acceptable investments declined, but the number of potential Stable Value players has also been reduced due to credit events. Notwithstanding bear market declines in portfolio values and claims-related drains on insurance companies' capital, insurers' credit ratings have also been negatively affected by the ratings agencies' apparent conservatism and proclivity to downgrade. Insurer downgrades have contributed to the reduction of the number of GICs being sold, as most purchasers seek GIC providers of at least a double-A credit rating. Similarly, plan sponsors' investment guidelines might proscribe entering into Stable Value agreements with single-A rated carriers or wrap providers, thus effectively barring such firms from participation in the Stable Value market.

Banks have not suffered the same credit degradation as insurers. Upgrades of S&P-rated U.S. banks outpaced insurance companies. For banks there were 4 upgrades and one downgrade and for insurance companies there were 39 downgrades and five upgrades. Despite their relative credit strength, several banks have also left the Stable Value market. Unlike insurers who have been edged out of the market due to inadequate credit ratings, banks have generally departed for internal reasons – insufficient market share or strategic realignment following mergers and restructuring.

The major ratings agencies predict improvements in issuer creditworthiness this year, and the critical light cast on the agencies will doubtless wane. Whether as the direct response to criticism, or the result of increased sophistication following criticism, the agencies' more conservative rating methods will probably become the norm. Investors within and outside the Stable Value industry can only hope that, as the ratings agencies respond to public criticism and adapt to changing markets, their ratings paint an increasingly accurate and predictive picture of the credit landscape. SVIA



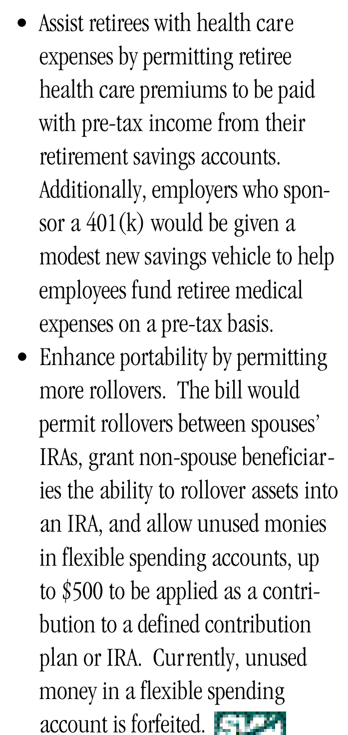
The Spirit of HR 1776: Save!

By Gina Mitchell, SVIA

Congressmen Rob Portman (R-OH) and Ben Cardin (D-MD) have introduced a third installment of pension reform: The Pension Preservation and Savings Expansion Act (H.R.1776). The bill takes up what the 2001 tax relief left undone, mainly increasing the tax-deferred savings limits for pensions and making these new limits permanent.

Despite concerns about the growing federal deficit and a 50 to 51 Senate-passed economic package, H.R.1776 is likely to pass the House sometime this summer. Listed below are some of the highlights of the bipartisan bill that currently has 18 co-sponsors.

- Encourage more savings by increasing the tax deferral limits for IRAs and defined contribution plans. For individuals under 50, the IRA limit would move from the current $3,000 limit to $5,000, and the 401(k) limit would move from its current limit of $13,000 to $15,000. For individuals over 50, the IRA limit would move from $3,500 to $6,000, and the 401(k) limit would move from $16,000 to $20,000.
- Make savings reforms contained in the bill and in the 2001 tax relief act permanent.
- Give workers greater protections over their retirement plan. These new rights include the ability to diversify company stock that is contributed to their 401(k) account; create a new tax incentive to help employees pay for retirement advice and counseling; and require employers to provide generally accepted investment principles upon enrollment into a 401(k) plan and in quarterly statements.
- Raise the mandatory pension distribution age of 70 and a half to age 75, which reflects the growing life expectancy of Americans.
- Replace the interest rate for defined benefit plans. The legislation will change the 30-year Treasury bond rate to a benchmark based on long-term conservative corporate bond rates for funding, premium and lump sum calculations. The bill will provide a transition for older workers so that their expectations regarding lump sum amounts are not undercut.
- Assist retirees with health care expenses by permitting retiree health care premiums to be paid with pre-tax income from their retirement savings accounts. Additionally, employers who sponsor a 401(k) would be given a modest new savings vehicle to help employees fund retiree medical expenses on a pre-tax basis.
- Enhance portability by permitting more rollovers. The bill would permit rollovers between spouses' IRAs, grant non-spouse beneficiaries the ability to rollover assets into an IRA, and allow unused monies in flexible spending accounts, up to $500 to be applied as a contribution to a defined contribution plan or IRA. Currently, unused money in a flexible spending account is forfeited. SVIA



What You, Your Parents, and Your Kids Have In Common: Money Worries

GAO Studies Generational Equity of Wealth and Future Income

By Gina Mitchell, SVIA

Congressman Robert Andrews (D-NJ), the ranking minority member of the House Subcommittee on Employer-Employee Relations worries about our future retirement security and our ability to maintain a standard of living during in our golden years. He recently asked the General Accounting Office (GAO) to look at retirement income for three generations: current retirees, baby boomers and Generation X to see how they are faring.

"Retirement Income: Intergenerational Comparisons of Wealth and Future Income," compares wealth across the three generations: Pre-Baby Boom, Baby Boom and Generation X. GAO used the Federal Reserve Board's Survey of Consumer Finances, a nationally representative database on assets and debt that goes as far back as 1962. GAO selected the age group of 25 to 34 year olds as the basis of the study since comparable data was available for all three generations. The data was adjusted in terms of real dollars to make it comparable for all three generations. An overview of retirement income sources is provided in Chart 1.

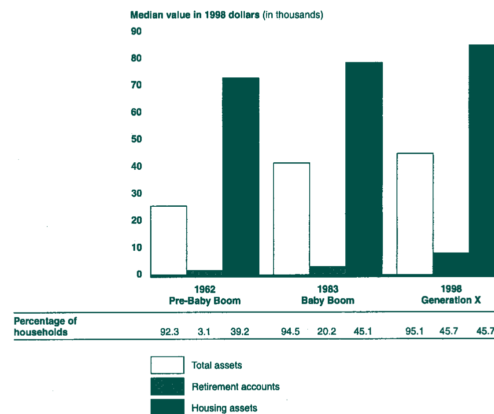
The Good News

GAO reports that Baby Boom and Generation X have greater accumulated assets adjusted for inflation than current retirees had when they were the same age as illustrated in Chart 2. GAO attributes Baby Boomers' wealth to increases in home equity and increases in the rate of home ownership. They report that the median value of housing assets increased from $72,890 for Pre-Baby Boomers to $78,583 for the Baby Boom, while the percent of households owning their own home also increased from 39 to 45 percent.

Despite earlier reports that Generation X will get the short end of the stick, GAO reports that Xers beat out the Boomers when it came to retirement savings. GAO reports that Generation X will have more money in their 401(k) account. GAO found the median value of 401(k) account increased from $2,947 for a Boomer to $8,003 for Generation X.

Additionally, the percentage of households with 401(k) accounts increased too, from 20 to 40 percent for Generation X. GAO attributes the increased coverage by 401(k) plans to the switch from defined benefit to defined contribution plans. They

Chart 2. Median Value of Total Assets, Retirment Accounts, and Housing Assets, and the Percentage of Households with these Assets for Households Headed by a 25- to 34-Year Old



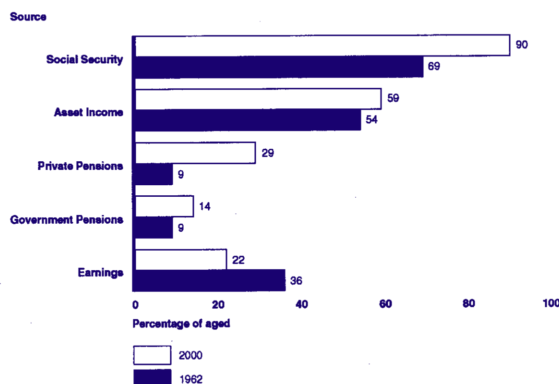
Note: GAO analysis based on data from the Survey of Consumer Finances. The median for housing assets is larger than the median for total assets because these medians come from two different distributions. Total assets include bank accounts and automobiles as well as housing, so the distribution of th value of total assets ranges from assets with relatively low values, such as bank accounts and other financial assets, to assets with relatively high values, such as houses. The distribution for housing assets includes only those households owning a home, whereas the distribution for total assets includes all households with any type of asset, including those who do not own homes.

report that the percentage of workers covered primarily by a 401(k) plan increased from 11 to 25 percent while the percentage of workers covered by a defined benefit plan declined from 35 to 21 percent. However, GAO did not estimate the value of defined benefit pensions and to the extent that the Pre-Baby Boom and Baby Boom generations enjoy defined benefit pensions, their assets are underestimated in the study.

Other financial and non-financial assets contribute only modestly to

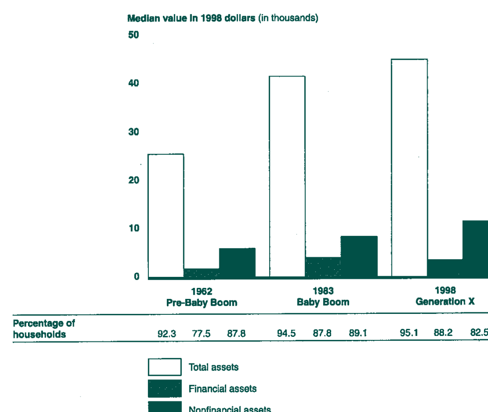
continued on page 6

Chart 1. Percentage of the Aged Receiving Income, by Source



Note: The aged include couples and nonmarried persons age 65 or older.

Chart 3. Median Value of Total Assets, Retirment Accounts, and Housing Assets, and the Percentage of Households with these Assets for Households Headed by a 25- to 34-Year Old



Note: GAO analysis based on data from the Survey of Consumer Finances.

Money Worries

continued from page 5

the increase in total assets across the three generations as shown in Chart 3. Financial assets include savings accounts, mutual funds, and stocks and bonds. Non-financial assets include vehicles, business interests and nonresidential real estate.

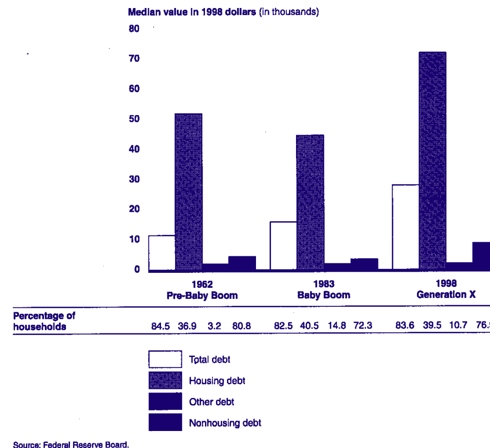
Lastly, GAO found that education, home ownership, length of work life, marital status, savings, and whether someone stays married or get divorced greatly influenced potential retirement security.

The Bad News

Baby Boomers and Generation X have more debt than the Pre-Baby Boom generation as shown in Chart 4. GAO attributes the rising debt levels to increases in housing debt. Of the three groups, Generation X carries the most debt. GAO found that the median level of debt for the Baby Boom is 38 percent greater than the Pre-Baby Boom generation while Generation X's median level of debt is 146 percent greater than the Pre-Baby Boom generation and 78 percent greater than the Baby Boom. GAO found that the percentage of households with debt changed very little across the generations, remaining roughly at 83-84 percent across the board. They concluded that those households that go into debt are going into debt more deeply with each new generation.

GAO is quick to point out that despite rising levels of debt that net worth is 60 percent greater than that of current retirees when they were the same age for Baby Boom and Generation X households with positive net worth at age 25 to 34. This point is illustrated in Chart 5. Despite greater net worth, increases in longevity may test both the ability to retire and length of retirement, not to mention the standard of living in

Chart 4. Median Value of Debt and the Percentage of Households with Debt for Househoulds Headed by a 25- to 34-Year Old (Total Debt, Housing Debt, Financial Debt, and Other Debt)

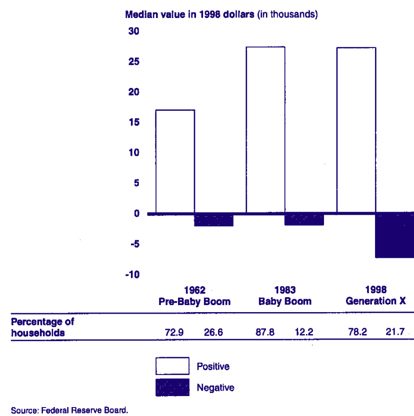


Note: GAO analysis based on data from the Survey of Consumer Finances. The median for housing debt is larger than the median for total debt because thee medians come from two different distributions. Total debt includes credit card and installment debt as well as housing debt. Because the distribution of the value of total debt includes relatively low levels of nonhousing debt as well as the higher levels of housing debt, the median will be lower than the median for housing debt. Nonhousing debts includes debt for other residential property, such as vacation homes, debt for nonresidential real estate, business debt, credit card debt, and installment loans, Other debt includes loans against pensions, loans against life insurance, and margin loans.

retirement for the later two generations. In fact, GAO predicts that Generation X will feel the pinch of longevity most and anticipates that Xers' income replacement rate will be lower than the other two generations.

Additionally, GAO warns that retirement security for Baby Boomers and Generation X will be complicated by several factors, which are beyond their individual control. These factors include the rate of growth of real wages, the overall performance of the economy, the rate of return on financial assets, changes in housing prices, shifts in pension coverage and the generosity of benefits, the state of the health care system, changes in life expectancy, and the resolution to the funding shortfall for Social Security and Medicare.

Chart 5. Median Value of Positive and Negative Net Worth and the Percentage of Households with Net Worth for Households Headed by a 25- to 34-Year Old



Note: GAO analysis based on data from the Survey of Consumer Finances. Net worth is defined as assets minus debt. If assets are greater than debt, the household has positive net worth. If debt is greater than assets, the household has negative net worth. Therefore, the positive and negative net worth columns will not sum to total net worth since they are based on different distributions.

Predictions

GAO offers no predictions from their study. In fact, they warn there is considerable uncertainty involved in their estimates starting with the assumptions and consideration of behavioral responses.

Just the Facts

What GAO does point out is that future retirees have a tougher row to hoe. Social Security trust funds are projected to be exhausted in 2042, which means unless action is taken, Social Security will no longer be able to pay scheduled benefits. Pension coverage has remained at 50 percent of the workforce while the composition of the coverage has shifted from defined benefit to defined contribution plans. This shift has put more responsibility on individuals to provide for their own retirement income. Plus, workers today are saving a smaller portion of their incomes than earlier generations did.

GAO does offer some sage advice for Baby Boomers and Generation X. That is to save more in order to maintain their standards of living and meet increasing health care costs in retirement. The challenge before future generations of retirees is not only to save more but also to invest better. That is why it is important that all retirement investors have a Stable Value Fund available to them. It makes a tough job a little easier since Stable Value provides not only diversification, but also safety through principal protection and certainty when it comes to earnings.

529 Plans and Stable Value

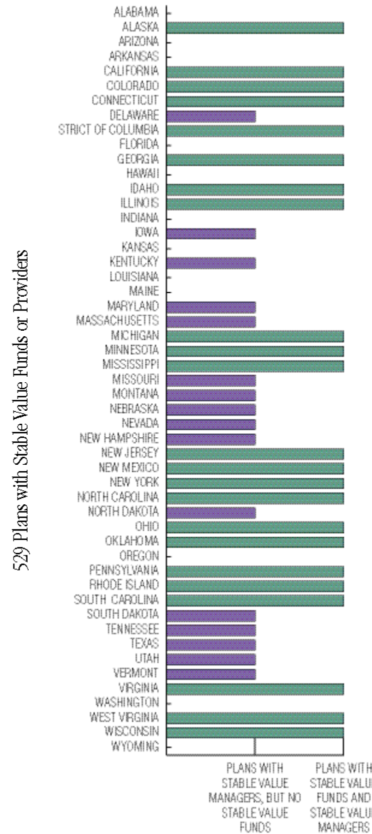
By Gina Mitchell, SVIA

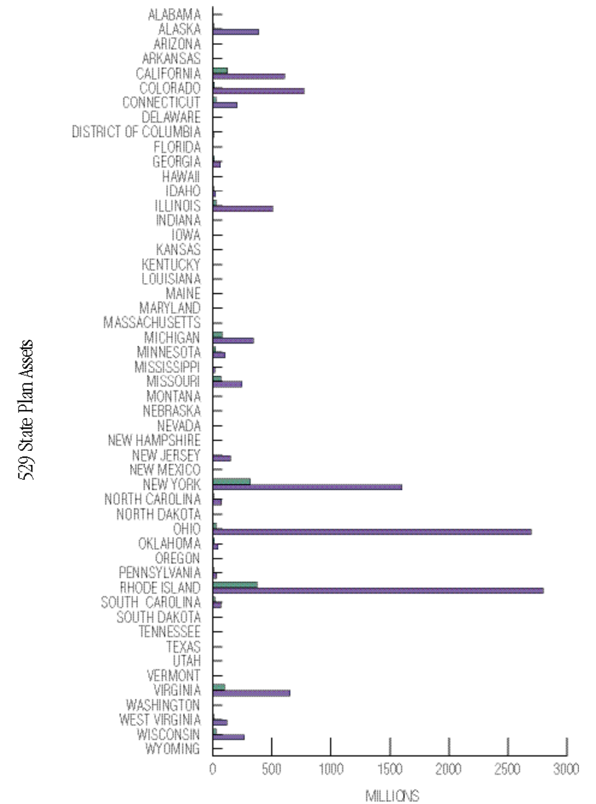
Money Magazine recently reported that 529 college savings plans had grown to $19.2 billion during 2002. That's a 209 percent increase during a bear market! And yes, Stable Value is a part of this important new savings market according to a joint SVIA and Travelers Life & Annuity Survey, which covered 529 assets as of March 31, 2003.

In fact, the SVIA/Travelers' Survey found that:

- 24 states now offer a Stable Value Fund as part of their 529 college savings plans. States with a Stable Value Fund account for 60 percent of all college savings plan assets or $11.7 billion.
- Stable Value Funds gathered 6 percent of all 529 college saving plan assets or $1.254 billion.
- Another 14 state plans have a Stable Value provider but do not yet offer a Stable Value Fund.

The survey found that Stable Value is becoming a significant option for 529 plans. The longer the plan and the Stable Value option were in existence, the more money is contributed to both the plan and option.





Survey Finds Division on Economic Stimulus Package

By Gina Mitchell, SVIA

In the First Quarter of Stable Times, readers were asked to participate in a brief Internet survey on President Bush's economic stimulus package. Like the Washington debate, participants in the survey were strongly divided.

When asked which is the more pressing economic concern, 38 percent said cutting taxes to stimulate the economy. The majority, 63 percent, said controlling the federal deficit to help keep interest rates low was a more pressing concern.

On the elimination of taxation of dividends for individuals, our survey participants squared off with 50 percent supporting the elimination of the dividend taxation and 50 percent opposing elimination. They were also evenly split as to the fairness to all taxpayers on the elimination of dividend taxation.

The half who supported ending taxes on dividend payments to individuals gave three reasons for their support:

- 25 percent believed it would boost the stock market;
- 25 percent said it would increase the money they had to spend;
- 50 percent said it would increase the money they had to save and invest.

Although only half of the survey supported elimination of the dividend tax, 75 percent thought it was unfair to tax dividends twice.

Additionally, it was unclear if the group would change their investment behavior as a consequence to a change in the tax treatment of dividends. They gave conflicting responses. 75 percent said they would hold stocks that paid a dividend in taxable account while 88 percent said they were likely to hold stocks that pay dividends in tax-deferred accounts.

Interesting, all indicated that they currently saved and invested. No one who participated in the survey said they did not or could not save or invest.

However, the group sent an inconsistent message on tax-deferred vehicles and President Bush's new savings vehicles. 50 percent said they were only willing to save on a pre-tax basis. Further, 75 percent said the primary reason they invest in a defined contribution plan is the tax deferral. The remaining 25 percent cited the primary reason they invested in a 401(k) plan as the employer match.

The group vacillated when asked if they would invest in President Bush's new after-tax savings vehicles. 63 percent said they would be interested in the proposed after tax savings vehicles such as the lifetime savings accounts, retirement savings account or employer savings account.

When asked which investment

continued on page 8

House Debates Advice Legislation, Bill Passes & Waits for Senate Action

By Gina Mitchell, SVIA

The U.S. House of Representatives once again passed advice legislation, The Pension Security Act (H.R. 1000) on May 14. Unlike its previous passage, the debate was a little more contentious and the margin of victory was greater. The bill passed by a vote of 271 to 157 compared to the previous year's vote of 255 to 163.

Congressman John Boehner (R-OH), a co-author of the bill explains, "Despite all the sound and fury orchestrated on the floor today by the House Democratic leadership, the President's pension reform proposal was again approved with significant bipartisan support. The bill has bipartisan support because it is about the pension security of American workers…Expanding worker access to quality investment advice is the most important pension protection of all."

"I want to help Americans who are working hard and saving for their retirement. They deserve more information about what is happening to their retirement plans. They deserve help in making financial decisions that can often be overwhelming. They deserve the right to diversify their money in their retirement accounts," says Congressman Sam Johnson (R-TX) who co-authored the bill with Boehner. "The Pension Security Act lets hard working Americans do all of this," explains Johnson.

However, Congressman George Miller (D-CA), the Senior Democrat on the Committee on Education and Workforce that has jurisdiction over the bill and organizer of the Democratic protest, characterized the Republican-sponsored bill as no more than, "See no evil, hear no evil and do no good."

Miller charged that, "Once again, in the shadow of the failures of Enron and Global Crossing, with the recent disclosures about Delta and American Airlines, the Republicans bring forward a pension bill that does nothing to help employees, but includes lucrative benefits for corporate interests. In every respect, their bill fails to provide a solution to the serious pension equities and risks faced by American employees."

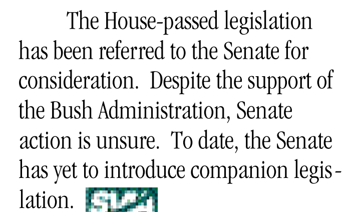
Even New York Democrat Attorney General Eliot Spitzer entered the fray on the Pension Security Act by releasing a statement that said, "This legislation opens a loophole that will sharply erode, rather than enhance, safeguards for employees seeking independent and untainted advice about how to invest their retirement savings. Clearly, this bill puts the interests of Wall Street firms far ahead of the interests of millions of working Americans who simply want a fair shake in making sound decisions about their retirement investments."

Briefly, the Pension Security Act as passed by the House:

- Gives employees the opportunity to diversify matches made in company stock within three years after receiving the match.
- Permits investment management firms to also provide investment advice as long as certain fiduciary safeguards and disclosures are met to ensure that the advice provided to an employee is solely in his or her best interest. Additionally, the bill creates a tax incentive to help employees pay for the cost of retirement planning services.
- Clarifies that employers have a fiduciary responsibility for workers' savings during blackout periods.
- Requires companies to give quarterly benefit statements that include account information such as the value of the assets, rights to diversify, and the importance of maintaining a diversified portfolio.
- Simplifies defined benefit pension plan sponsorship for small businesses.

Two provisions of the original Pension Security Act were enacted as part of the Sarbanes-Oxley corporate accountability law. These provisions bar company insiders from selling their stock during a blackout period where workers cannot make changes to their 401(k) accounts, and require that all workers receive 30 days advance notice of any blackout period.

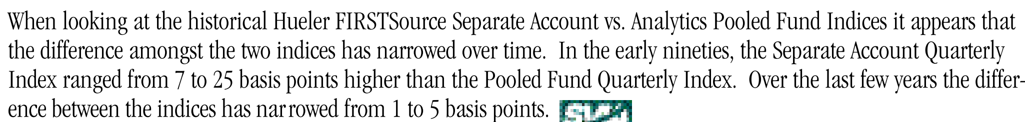
The House-passed legislation has been referred to the Senate for consideration. Despite the support of the Bush Administration, Senate action is unsure. To date, the Senate has yet to introduce companion legislation.

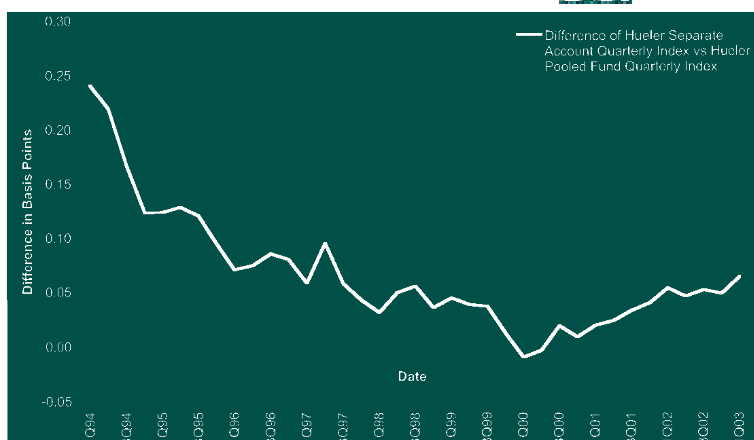


A Look Back in Time… Separate Account vs. Pooled Fund Index Returns

By Kathleen Schillo, Hueler Analytics

When looking at the historical Hueler FIRSTSource Separate Account vs. Analytics Pooled Fund Indices it appears that the difference amongst the two indices has narrowed over time. In the early nineties, the Separate Account Quarterly Index ranged from 7 to 25 basis points higher than the Pooled Fund Quarterly Index. Over the last few years the difference between the indices has narrowed from 1 to 5 basis points.





Hueler FIRSTSource Separate Account Index vs. Hueler Analytics Pooled Fund Index

The FIRSTSource Separate Account Index represents the returns of 180 separately managed Stable Value funds, across 14 managers totaling $66 billion in Stable Value assets. The Analytics Pooled Fund Index is comprised of 25 Stable Value pooled funds totaling $60 billion in Stable Value assets.

Survey Results

continued from page 7

vehicles they used, 100 percent reported using traditional IRAs; 25 percent used Roth IRAs (after tax contributions); 75 percent reported using defined contribution plans and 37 percent invested in 529 college savings plans.

Further, when asked if they contributed the maximum amount permitted in these tax-deferred vehicles, 37 percent reported maximizing their contributions to traditional IRAs; 12 percent to Roth IRAs; 71 percent to defined contribution plans; and 12 percent to 529 college savings plans.

80 individuals participated in the SVIA Economic/Tax Poll. The majority, 75 percent were not SVIA members. 25 percent of participants were SVIA members.