SVIA STABLE TIMES

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IN THIS ISSUE

401(k) Plans Wrestle with New Trading Restrictions 1
By Randy Myers

For Want of the Nail, the Shoe Was Lost….403(b) Plans Find the Nail 1
By Joseph T. Chadwick, Jr., The Chadwick Group, Inc.

Editor's Corner 2
By Steve LeLaurin

New GICs Offer Inflation Protection to Stable Value Funds 4
By Randy Myers

Stable Value Managers Tap Growing Array of Tools to Hedge Against Inflation 6
By Randy Myers

Stable Value & Social Security: What Could the Push for Social Security Privatization Mean for Stable Value? 7
By Chris Tobe, AEGON Institutional

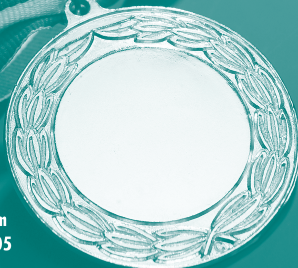
Stable Value to Have a Home in Roth 401(k)s 9
By Randy Myers

New EU Capital Markets Regime to Significantly Impact Issuers of FA-Backed Notes 10
By Helena Wilmer, Credit Suisse First Boston

Rethinking Retirement: Americans Must Have New Tools to Prepare for Retirement…and a New Definition of Retirement Itself 11
By Cynthia Hayes, CFA, Retirement Group, Merrill Lynch

ACHIEVING SUCCESS

A Look at How Market Forces and Regulation Are Affecting Retirement Security & Stable Value



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401(k) Plans Wrestle with New Trading Restrictions

By Randy Myers

Trading restrictions in retirement savings plans aren't just for stable value funds anymore.

Nearly two years after the mutual fund industry was roiled by reports of market-timing and late trading by professional investors at the expense of individuals, many employers are taking steps to protect their employees from abusive trading in 401(k) plans. At the same time, mutual fund companies are instituting trading restrictions of their own. The result is a hodgepodge of new trading rules which, while beneficial for most investors in the long run, are making retirement plans more complicated for active investors and plan administrators.

Studies have shown that very few retirement plan investors engage in excessive trading. Still, those that do can hurt the long-term returns of their fellow investors by driving up transaction costs. "As fiduciaries, plan sponsors have a responsibility to take action if they think the trading behavior of some participants is hurtful to others," observes Judy Schub, Managing Director of the Association for Financial Professionals'

continued on page 2

For Want of the Nail, the Shoe Was Lost….. 403(b) Plans Find the Nail

By Joseph T. Chadwick, Jr., The Chadwick Group, Inc.

For want of a nail, the shoe was lost,
For want of the shoe, the horse was lost,
For want of the horse, the rider was lost,
For want of the rider, the battle was lost,
For want of the battle, the kingdom was lost,
And all for the want of a horseshoe nail!

The childhood ditty emphasizes how the lack of a seemingly small detail can lose a battle or even a kingdom. A "nail" preventing the use of stable value portfolios in 403(b) programs has recently been found.

The stable value industry was born from such a situation. *On average, over the long term*, professionals agree that a diversified bond portfolio will produce higher average returns than a money market fund. However, a large majority of defined contribution participants are simply not willing to invest in a bond portfolio *at all* if its price were not stable. Participants would give up the substantial return pickup from bonds, imperiling their retirement planning, and direct their money to low yielding money market funds, fixed annuities or bank deposits. For want of the "nail" of book value accounting, the benefits of higher long term bond market returns would have been lost for defined contribution participants.

While some investment purists would argue that participants with a long term horizon should simply purchase an unwrapped bond fund (i.e., even the low cost of the obtaining book value protection should be avoided), this fails to recognize that most participants currently utilizing stable value funds would flock to much lower yielding money market funds in the absence of the book value protection. So the "extra" cost built into stable value portfolios to maintain book value was not really "extra". Furthermore, as the attached chart shows, the investors who would venture into the bond market have historically exhibited poor timing.

In 403(b) programs, the nail preventing access to the stable value products commonplace in the 401(k) market has been a legal constraint. For purely historical political reasons—certainly not investment or retirement savings policy—the Internal Revenue Code restricts 403(b) investments to annuity contracts or custodial accounts investing in mutual funds. Bonds, CDs, individual stocks and even commingled

continued on page 4

Editor's Corner

By Steve LeLaurin, INVESCO Institutional

Once again, we have put together an edition of *Stable Times* for your edification and enjoyment. It is always an interesting exercise for us to compile a list of articles. Sometimes we get nervous that we won't have enough to say that is topical, interesting, worthy, well-written, witty, intelligent, or just plain acceptable. Before our first organizational conference call, some of us wonder where we will get new ideas.

But we do have several important sources. The first is just the world we live in. Often business events of the day give us plenty of fodder for generating new and insightful information. We thought we were going to be able to report on new FASB conclusions about book value accounting in pooled funds, but there have been some delays in those proceedings. There apparently is some active debate about proposed disclosure requirements. Expect to see a FASB report from us next quarter.

Another source we rely on is Gina Mitchell's undying creativity in finding new things worthy of gracing our pages. A third source is the collective wisdom (such as it is) of the rest of the *Stable Times* editorial board. In addition to generating a list of topic ideas, we also have to come up with a suggested author. Often as not, the person bringing an idea to the table may offer to write it themselves, or find a knowledgeable source.

A challenge for us is to keep our information relevant, timely, and appropriate for our audience. We sometimes find an interest in exploring a new approach to stable value investing, but have to be careful to fairly present it without appearing to be too commercial or implying any kind of endorsement. In our zeal for impartiality we must avoid being unduly negative.

One of our strengths, at least in my opinion, is that—even though the editorial group is essentially exclusively from the "provider" community (i.e., no plan sponsors)—we have quite a few points of view. Insurance companies often view markets and risks differently from banks. Stable value investment managers often have varying investment views of attacking problems. Those from fixed income investment backgrounds offer a different perspective. Consulting firms may see things other providers don't. Gina's finger on the pulse of political climates in DC always gives us an interesting take on topics.

So we've ended up with stories about: Roth 401(k), stable value in a Social Security context, 403(b) plan, trading restrictions in plans, a glimpse of insurance company use of the EU capital markets, inflation implications for stable value, and more. We hope that offers our readers a diverse enough menu. And we promise that there will be more next time.

New 401(k) Trading Restrictions

continued from page 1

Committee on Investment of Employee Benefit Assets, which represents more than 110 of the nation's largest retirement plans. "The potential is there to hurt all the participants because all participants bear the cost of trading."

"This is a really important issue to plan sponsors," adds Kim McCarrel, Relationship Manager with stable value manager INVESCO Institutional. "I get a lot of questions from them about what other sponsors are doing."

Stable value funds, of course, have traditionally imposed restrictions on trading between their funds and directly competing investments, such as money market funds. The aim of such rules is to prevent plan participants from trying to arbitrage the difference in yields on the two products during periods of sharply rising interest rates. Cash pouring moving out of stable value into money market funds at such times could create liquidity problems might affect returns in for stable value funds, adversely impacting long-term shareholders.

Now such restrictions are becoming common for all types of retirement-plan investments. In a survey of

continued on page 3

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New 401(k) Trading Restrictions

continued from page 2

plans of varying sizes late last year, Deloitte Consulting LLP found that 23 percent had implemented broader policies restricting the frequency of inter-fund transfers among investment options, while 27 percent had imposed short-term trading fees for one or more investment options. Half the survey respondents said that if they found participants engaging in excessive trading they would send them a note advising them to stop. The rest said they would either freeze the participant's account or take other action.

Among very large plan sponsors-those with assets in excess of $1 billion-the adoption of trading restrictions has been even more widespread. When CIEBA surveyed its members last year, 69 percent of the respondents said they had already implemented such restrictions, and another 14 percent said they were planning to do so. The most popular option was limiting the number of trades plan participants could make (cited by 31 percent of respondents), followed by implementation of mandatory holding periods (25 percent) and redemption fees (23 percent). The most common redemption fee was 2 percent, and the most common holding period to avoid a redemption fee was 30 days.

As noted, many mutual fund companies also have begun to limit trading by retirement plan participants in their funds. Fidelity Investments, for example, implemented an excessive trading policy last December limiting retirement plan participants to one round-trip transaction per fund within any rolling 90-day period, subject to an overall limit of four roundtrip transactions across all funds over a rolling 12-month period. It defines a round trip as an exchange into and then out of a fund within 30 days. T. Rowe Price has a similar policy. Both firms this year also began imposing redemption fees on certain of their funds held in retirement plans. Fidelity generally imposes the fees regardless of the reason for the redemption, though, while T. Rowe Price generally does so only when investors transfer assets from one fund to another. The T. Rowe Price fees would not apply, for example, to a redemption made because the participant was leaving the plan due to retirement or a job change.

A new rule issued by the Securities & Exchange Commission (SEC) earlier this year limits redemption fees imposed by fund companies to 2 percent of the value of the transaction. Actual fees vary from one fund company to the next, and, at times, among funds offered by the same company. This has made more work for the third-party recordkeepers hired by most employers to manage their plans, especially when a plan offers mutual funds from a variety of fund families.

Transaction activity redemption fees in mutual funds typically stay in the mutual fund where the transactions happened as on offset to the theoretical extra fund costs to manage the transactions. If a plan imposed transaction fees associated with transactions in a stable value fund, presumable those transaction fees would also stay in the stable value fund as an additional income source for the remaining participants in the stable value fund.

To bring some semblance of order to the marketplace, the National Defined Contribution Council/SPARK Institute (NDCC/SPARK), a group of major retirement plan providers, has proposed to the SEC that the industry standardize the types of transactions to which redemption fees apply. "I think the industry is gravitating toward this," says NDCC/SPARK Institute President Charles Veith, also President of fund provider T. Rowe Price Retirement Plan Services. "We have already seen some fund complexes change their policies." The NDCC/SPARK Institute has recommended to the SEC that redemption fees apply only to participant-initiated exchanges of shares that were acquired in connection with a prior participant-initiated exchange. That means the charges wouldn't apply, for example, to a sale of shares acquired through routine payroll deductions.

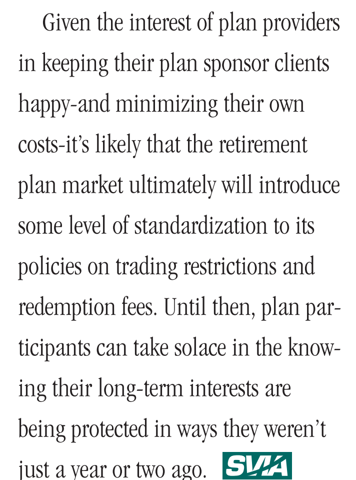
Some plan sponsors looking for consistency in their trading policies are taking matters into their own hands. Veith says those sponsors have looked at the restrictions imposed by the various funds they offer, picked the policies that seem most appropriate to them, and told the funds that either they must use that standard or see their funds removed from the plan.

Mary Kazan, Group Vice President for Corporate Benefits at apparel maker Phillips-Van Heusen Corp. in Bridgewater, New Jersey, is among the plan sponsors wrestling with the new restrictions. "We have five or six different fund companies represented in our plan, and until recently, they had all exempted retirement plan participants from their trading restrictions," Kazan says. "Now, some of the funds have said those restrictions apply to retirement plans, so we have had to start communicating to employees about them."

Kazan says her company is looking closely at the funds that have implemented new restrictions to decide whether they're still worth offering. "Some have gone kind of overboard," she says. Already, Phillips-Van Heusen is seriously considering eliminating one small cap fund that recently imposed a 1 percent redemption fee on roundtrip transactions that occur within a 180-day period. That isn't the only reason the company is considering removed from the fund-the plan offers another small-cap fund that has been performing more strongly-but Kazan says the new fee helped to solidify the company's interest in dropping it.

Another plan sponsor, who asked not to be identified, noted that his plan has had restrictions on excessive trading in its company stock fund and its international stock fund for several years, but is now planning to add restrictions on trading in its core, single-asset-class funds, too. "We're shifting from having a reactive approach to this issue to a more anticipatory approach," he says. "We're basically saying that frequent trading is bad and that we should have some sort of anticipatory rule in place such that it just can't occur-rather than waiting for it to occur and then dealing with it."

Given the interest of plan providers in keeping their plan sponsor clients happy-and minimizing their own costs-it's likely that the retirement plan market ultimately will introduce some level of standardization to its policies on trading restrictions and redemption fees. Until then, plan participants can take solace in the knowing their long-term interests are being protected in ways they weren't just a year or two ago. SVA



New GICs Offer Inflation Protection to Stable Value Funds

By Randy Myers

Inflation is a significant risk to stable value investors because it erodes the value of the interest earned on their investments. Now, stable value funds have a new way to hedge that risk: inflation-protected GICs, or guaranteed investment contracts.

Aegon Institutional Markets began selling "Inflation GICs," or I-GICs, late last year. By May 2005 it had sold five contracts and had a sixth deal nearing completion. While the company declined to divulge details of the contracts, its marketing literature specifies that the contracts require a minimum commitment of $5 million.

Aruna Hobbs, Head of the Pensions and Savings Group at Aegon, says the firm developed I-GICs after sensing an interest in, and need for, new GIC or GIC-like products from its customers, at the same time investors were becoming increasingly concerned about inflation.

Those inflation fears were not unfounded. The Consumer Price Index rose 2.7 percent in 2004, up from 2.3 percent in 2003 and 1.6 percent in 2002. By April of this year it was growing at an annualized rate of 3.5 percent. As a direct result, the Federal Reserve has been raising short-term interest rates. From June of last year through May of this year it boosted its target for the federal funds rate-the rate at which banks lend overnight reserves to one another-eight times, to 3 percent from 1 percent.

Stable value manager Greg Wilensky of Alliance Capital says it makes sense for stable value managers to look for ways to protect against inflation risk, but notes that I-GICs aren't the only tool available. Floating-rate GICs, TIPS, inflation swaps, inflation futures and corporate inflation-linked securities all offer some of the same protections, albeit with different mixes of benefits and drawbacks. Floating-rate GICs, for example, do not provide the same direct hedge against inflation that I-GICs provide, since their crediting rate is pegged to an interest rate, such as LIBOR. From time to time, interest rates are impacted by market factors other than inflationary pressures.

TIPS do offer a direct hedge against inflation, but differ from I-GICs in a variety of ways, including their underlying mechanics. With TIPS, it is the principal of the bond that gets adjusted for inflation, while the coupon stays the same. With I-GICs, it is the crediting rate that gets adjusted. TIPS pay interest semi-annually, while I-GICs pay interest monthly. There is an active secondary market for TIPS, while no such market exists, at least at this time, for I-GICs.

TIPS do not offer a benefit-responsive guarantee like the one offered by GICs; to get it, buyers also must purchase an insurance wrapper. (While it is true that TIPS buyers are guaranteed to get their full principal amount back if they hold their bonds to maturity, the value of a TIPS portfolio will fluctuate with the market in the interim.)

Finally, I-GICs provide opportunities for higher yields, albeit with higher credit risk, than do Treasury-issued TIPS, which are AAA-rated government-backed securities. To get similar yield enhancements with a true inflation-protected bond, stable value investors would have to look to the rather small universe of inflation-linked corporate bonds.

Hobbs argues that one of the primary benefits of hedging inflation risk with I-GICs is the opportunity to diversify an investment portfolio while also capturing what has been a fairly high initial crediting rate-about

continued on page 5

For Want of a Nail

continued from page 1

funds are simply not allowed under the Code. For lack of the legal nail, traditional stable value funds had been considered simply off limits to this segment of the retirement savings market.

A 403(b) Nail Has Been Found!

The State of Georgia currently offers three defined contribution plans—a 457 plan, a 401(k) plan, and a 403(b)7 custodial account. The 457 and 401(k) plans had been operating under a master trust arrangement for a number of years, allowing commonality of investment choices and the economies of scale of the combined entities. When the addition of a 403(b) element was being considered in 2000 for employees of State technical schools and county school boards, it was obvious that it would be advantageous to combine the 403(b) assets in the master trust as well. The problem was the Internal Revenue Code constraints on 403(b) investments. The stable value fund (called the Fixed Income Option or FIO) didn't fit.

At the same time, it was equally obvious that each of the components of the FIO *were* eligible investments. Traditional GICs are technically fixed annuity contracts. The cash "buffer" was invested in a money market fund. The bond portfolio was wrapped with an insurance contract which was also technically a fixed annuity. Georgia decided to seek a ruling from the Internal Revenue Service allowing the use of FIO in the 403(b) program.

The original submission in 2000 was supplemented several times with additional documents, discussions and explanations. The IRS issued a favorable ruling on July 8, 2002. "(We) conclude that the Fixed Income Option, which invests exclusively in annuities issued by insurance companies or the stock of one or more regulated investment companies, all pursuant to the requirements of section 403(b)(1) and section 403(b)(7) of the Code, blending of the returns of these underlying investments into the Fixed Income Option will not cause the Fixed Income Option to fail to meet the requirement of section 403(b)(1)."

The IRS ruling was the "nail" but Georgia still had to find some horseshoes, horses and riders to actually win the battle of implementation. The GIC/wrapper issuers had to agree to the new underwriting conditions created by the addition of 403(b) participants and a 403(b)(7) custodian had to be located who would agree to serve in an unprecedented role at a reasonable cost. Accounting procedures had to be put into place to keep the 403(b) assets commingled for some purposes but separately accounted for in other respects.

Peach State Reserves (as the combined Georgia programs are known)

continued on page 5

For Want of a Nail

continued from page 4

offered their stable value fund (the Fixed Income Option) to participants in the 403(b) component of their programs, effective July 1, 2004. The entire process took almost four years.

To be sure, there are still some "nails" missing which limit or prevent widespread availability of stable value options to 403(b) programs. The IRS ruling for the State of Georgia was a Private Letter Ruling. Private Letter Rulings are only binding on the IRS with respect to the party who actually received it. Many plan sponsors may not feel comfortable with proceeding without their own ruling. Private Letter Rulings take time—as much as a couple of years—and each plan may have its own set of horseshoes, horses and riders to deal with in order to implement a stable value option for 403(b) assets. However, the first nail is no longer missing.

Joseph T. Chadwick, Jr. is a Principal of The Chadwick Group, Inc. and served as a consultant to the State of Georgia Peach State Reserves program throughout the process. SVIA

Problem: Investors Buy & Sell Bond Funds at the Wrong Time

Source: ICI Data and Bloomberg. Data through January 31, 2005

- This chart provides a 15-year comparison of sales of long-term mutual bond funds to 10-year Treasury yields.
- Investors have historically had a tendency to buy bond funds when interst rates are low (and prices high) and the exit bond funds after interest rates rise and prices fall.

Source: Thornburg Investment Management

Editor's note: This informed article represents its author's knowledge of and experience with the State of Georgia plans and their ability to combine the 403(b) program's investment options with their 457 and 401(k) investment options. While other 403(b) plans have long used "stable value" investment options in their plan lineups, they have usually been limited to single product insurance company group annuity contracts, portfolios of GICs with another insurance company "wrapping" the whole portfolio, or insurance company separate accounts wrapped by a group annuity contract. The State of Georgia's uniquely structured Fixed Income Option blends the return of a money market fund cash buffer and GICs. The State of Georgia's use of insurance company-issued synthetic GIC contracts wrapping bond portfolios is fairly unique as well. In this context, the insurance company wrap contracts are "group annuity" contracts, thus meeting the unique 403(b) annuity contract requirement.

We also know that the 403(b) market is, at best, "murky" in that it is very hard to completely understand how it works. There are a number of different types of 403(b) plans for different constituent groups, and opinions differ on the investment arrangements available for all. In any case, we welcomed the opportunity to air the description of success for the State of Georgia.

New GICs

continued from page 4

4.7 percent in late May. Back then, that was roughly in line with the crediting rate available on traditional GICs of the same maturity. I-GICs also offer portfolio diversification benefits to stable value managers. Thanks to their built-in inflation hedge, Aegon says, I-GICs offer low or even negative return correlations with bonds and many other asset classes.

David Molin, Vice President and Director of Research for Fiduciary Capital Management Inc. in Wallingford, Connecticut, says his firm brought a five-year Inflation GIC in January. The firm manages about $1.8 billion in stable value assets with approximately 80 percent of its portfolio allocated to GICs and the balance to synthetic GICs. Molin says that before buying the I-GIC was yielding about 10 basis points more than five-year TIPS, and its initial crediting rate of 453 basis points was 36 points higher than a fixed-rate GIC. By early June, he says, the crediting rate was still about 10 basis points over a fixed-rate GIC. He says FCM has calculated that over the life of the I-GICs, its return will match that of a fixed-rate GIC if the CPI rises at an average rate of 3.10 percent annually. If inflation exceeds that rate, he says, the I-GIC will prove to have been a better investment. If inflation is lower, it will have offered lower returns. "With oil prices going up, we felt this would be a good hedge against any potential oil crisis," Molin says. In addition to offering a higher yield, Molin says the I-GIC promised to be simpler to manage than a TIPS investment from a client reporting perspective, since its crediting rate, not the underlying

continued on page 6

Stable Value Managers Tap Growing Array of Tools to Hedge Against Inflation

By Randy Myers

Just as it is for any fixed-income security, inflation is a risk for stable value funds. Over the long term, it erodes the purchasing power of underlying investments, whether those are traditional guaranteed investment contracts (GICs) or bond portfolios backed by insurance wrappers. In the near-term, inflation fears can cause interest rates to rise and reduce the market value of those investments.

Lately, inflation has been on the upswing. The Consumer Price Index rose 2.7 percent in 2004, up from 2.3 percent in 2003 and 1.6 percent in 2002. It continued to climb through the first four months of this year, hitting an annualized rate of 3.5 percent by April, before backtracking to an annualized rate of 2.8 percent in May.

Fortunately, stable value managers are able to tap a broad and growing array of tools and strategies to mitigate the impact of rising inflation on their portfolios, including inflation linked bonds and inflation derivatives. To guard against increased interest rates brought about by inflationary fears, managers also can reduce portfolio durations by purchasing shorter maturity or floating-rate securities.

The market for inflation linked securities in the U.S. began in 1997, when the U.S. government began issuing Treasury Inflation-Protected Securities, or TIPS, which receive principal adjustments linked to movements in the U.S. Consumer Price Index, a popular measure of inflation. This market has expanded rapidly and now include securities worth more than $225 billion. As the TIPS market has expanded, other corporate, agency and municipal issuers have piggybacked on the investor demand for inflation-linked fixed income securities. Most recently, Aegon Institutional Markets late last year began selling "Inflation GICs," or "I-GICs," whose returns also are linked to the Consumer Price Index.

Which inflation hedges a stable value manager uses depends in part on the way his portfolio is invested. Alliance Capital, for example, exclusively manages wrapped bond portfolios, and it periodically invests in TIPS. "We use them opportunistically," says Greg Wilensky, Director of Stable Value Investments for Alliance Capital, "meaning we use them when the breakeven inflation rate—the difference in yield between a TIPS and a comparable maturity conventional Treasury-is below our longer term inflation forecast. We also have discussed using TIPS on a strategic basis-that is, adding them to the account benchmark-with some stable value clients and prospects."

Stable value manager Fiduciary Capital Management, by contrast, invests about 80 percent of its stable value portfolios in GICs and doesn't include TIPS in its portfolio. However, David Molin, Vice President and Director of Research for FCM, says the firm did buy a five-year Inflation GIC in January after comparing it to alternative investments, including TIPS, inflation-linked AA-rated corporate bonds and traditional fixed-rate GICs. At the time, the I-GIC's initial crediting rate of 4.53 percent was about 10 basis points higher than the yield on a five-year TIPS and 36 basis points higher than the yield on a comparable fixed-rate GIC, he says. By early June, the crediting rate was still about 10 basis points over a fixed-rate GIC. He says FCM calculates that the I-GIC will prove to be a better investment than a fixed-rate GIC if, over its five-year life, the CPI rises by an average of 3.10 percent or more annually. "With oil prices going up, we felt this would be a good hedge against any inflation scenario, including a potential oil crisis," Molin says.

I-GICs are built on a traditional floating-rate GIC platform. Their monthly interest payments are linked to year-over-year changes in the Consumer Price Index plus a fixed spread established at the contract's inception. For example, if the inflation rate based on the year-over-year percent change in the CPI was 3.5 percent at the time a contract was sold, and the spread was 100 basis points, the initial crediting rate would be 4.5 percent. Because of the seasonal factors and the spikes and troughs common in the CPI, the initial crediting rate on an I-GIC as with other floating-rate securities, may not be the best indication of the expected yield over the life of the security.

Pluses and Minuses

While all of the inflation-protection tools available to stable value managers can help them manage

continued on page 7

New GICs

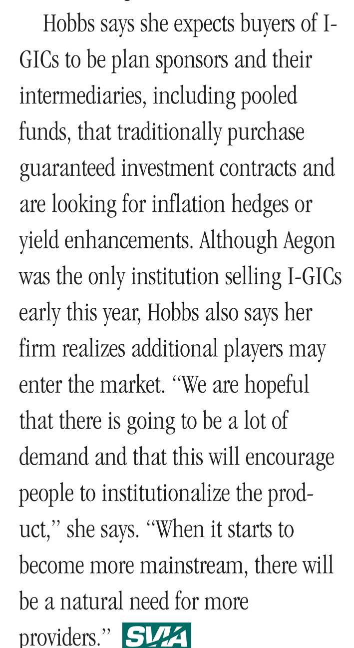
continued from page 5

principal amount, floats with inflation. "It just fit better into our stable value portion as far as reporting the crediting rate to the client," he says. "It was more of a true floater."

Indeed, I-GICs are built on a traditional floating-rate GIC platform, and like traditional GICs they do provide a principal guarantee. Their monthly interest payments are linked to year-over-year changes in the Consumer Price Index plus a fixed spread established at the contract's inception. For example, if the inflation rate based on the year-over-year percent change in the CPI was 3.5 percent at the time a contract was sold, and the spread was 100 basis points, the initial crediting rate would be 4.5 percent.

Hobbs says the spread available to I-GIC investors at any given time will vary depending upon market conditions. Generally, the spread will be smaller when inflation expectations are high, and larger when inflation expectations are low. Early this year, the spread was hovering around 100 to 120 basis points.

Hobbs says she expects buyers of I-GICs to be plan sponsors and their intermediaries, including pooled funds, that traditionally purchase guaranteed investment contracts and are looking for inflation hedges or yield enhancements. Although Aegon was the only institution selling I-GICs early this year, Hobbs also says her firm realizes additional players may enter the market. "We are hopeful that there is going to be a lot of demand and that this will encourage people to institutionalize the product," she says. "When it starts to become more mainstream, there will be a natural need for more providers." SVIA



Stable Value & Social Security: What Could the Push for Social Security Privatization Mean for Stable Value?

By Chris Tobe, CFA, AEGON Institutional Markets

For many reasons, President Bush appears to be facing an uphill battle in passing Social Security reform legislation that would partially privatize the government-run program. Nevertheless, the President continues to press his case for reform and his political will should not be underestimated. If he succeeds, what might "partial privatization" look like and how might stable value, as an asset class, fit into this paradigm?

To date, the President has not presented a specific and detailed plan; rather, he has proposed reform objectives based on certain principles. The first of these principles is to preserve the current level of benefits for retirees and near-retirees. The second is to maintain current levels of Social Security taxation; i.e., Bush would not increase the payroll tax that currently funds Social Security.

The third principle is where "privatization" comes in. The President proposes to establish voluntary "personal retirement accounts" for younger workers that would prefund a portion of their income during retirement. Individual workers could elect to divert a portion of their payroll taxes into these personal accounts, which would then grow tax-deferred. The balance in these accounts would be available to individuals at retirement, thereby reducing their need for guaranteed benefits from the government.

Critics maintain that such accounts would place retirement funds in jeopardy by shifting market risk to individual investors, while ensuring windfall profits for the Wall Street firms involved in managing these accounts. Wall Street, by and large, has adopted a "wait-and-see" approach to the President's proposals, primarily because it is far from certain yet how these personal accounts would be structured and what types of investments would be permissible.

The most likely scenario at this stage, and one floated by the Bush Administration itself, is that such personal retirement accounts would be modeled after the government Thrift Saving Plan (TSP) available to federal workers and members of Congress. According to a White House statement released on February 10, 2005:

The system of personal retirement accounts would be similar to the Federal employee retirement program, known as the Thrift Savings Plan (TSP). Contributions would be collected and records maintained by a central administrator. Personal retirement accounts would be invested in a mix of conservative bond and stock funds. Workers would be permitted to allocate their personal retirement account contributions among a small number of very broadly diversified index funds patterned after the current TSP funds.[i]

Based on this information, one could make the reasonable assumption that some form of stable value-possibly amounting to hundreds of billions in total plan assets-would be front and center in a partially priva-

continued on page 8

Stable Value Managers Hedge Against Inflation

continued from page 6

inflation risk, each does so with a different mix of benefits and drawbacks. Floating-rate GICs, for example, do not provide the same direct hedge against inflation that I-GICs, TIPS or other inflation-linked securities provide, since their crediting rate is pegged to an interest rate, such as LIBOR, rather than inflation-and sometimes, interest rates are impacted by market factors other than inflation.

TIPS do offer a direct hedge against inflation, but differ from I-GICs and most other recently issued inflation-linked bonds in a variety of ways, including their underlying mechanics. As noted earlier, with TIPS, it is the principal of the bond that gets adjusted for inflation, while the coupon stays the same. With I-GICs, it is the crediting rate that gets adjusted. TIPS pay interest semi-annually, while I-GICs pay interest monthly. There is an active secondary market for TIPS, while no such market exists for I-GICs. Both inflation-linked securities issued by corporations and agencies and I-GICs provide opportunities for higher yields, albeit with higher credit risk, than do Treasury-issued TIPS, which are AAA-rated government-backed securities.

Aruna Hobbs, Head of the Pensions and Savings Group at Aegon, argues that one of the primary benefits of hedging inflation risk with I-GICs is the opportunity to diversify an investment portfolio while also capturing what has been a fairly high initial crediting rate-about 4.7 percent in late May. Back then, that was roughly in line with the crediting rate available on traditional GICs of the same maturity. I-GICs, like other inflation-linked securities, also offer portfolio diversification benefits to stable value managers. Thanks to their built-in inflation hedge, they offer low or even negative return correlations with bonds and many other asset classes.

Hobbs says the spread available to I-GIC investors at any given time will vary depending upon market conditions. Generally, the spread will be smaller when inflation expectations are high, and larger when inflation expectations are low. Early this year, the spread was hovering around 100 to 120 basis points.

Hobbs says she expects buyers of I-GICs to be plan sponsors and their intermediaries, including pooled funds, that traditionally purchase guaranteed investment contracts and are looking for inflation hedges or yield enhancements. They also may appeal to stable value funds that invest in medium-term notes. By May 2005, the firm had already sold five contracts and was nearing completion of a sixth deal. Although Aegon was the only institution selling I-GICs early this year, Hobbs recognizes that additional players may enter the market. In fact, she says, "We are hopeful that there is going to be a lot of demand and that this will encourage people to institutionalize the product. When it starts to become more mainstream, there will be a natural need for more providers."

With the growing array of hedging tools available to them, stable value managers may not be able to ignore inflation risk, but they can manage it. SVIA

Stable Value & Social Security

continued from page 7

tized Social Security system. Why? Of the $141 billion in total plan assets invested in the TSP, nearly half-$65 to $70 billion-is allocated to a stable value option called the "G Fund,"[ii] which is invested exclusively in specially issued U.S. Treasury securities. Interestingly, both President Bush and Vice President Cheney have noted the returns available from the G-Fund as a way of touting the Administration's reform proposals. During a Town Hall meeting in Smyrna, Georgia on May 2, 2005, for example, Vice President Cheney had this to say about the TSP funds: "… the most conservative [the stable value G Fund], has gone up about four percent per year. …. Now compare that to the rate of return that you, in effect, get on your Social Security when you pay into the regular Social Security trust fund, that's less than 2 percent." That is essentially the same argument the stable value industry has used for years when comparing stable value returns to money market returns.

What is the G Fund and what makes it a stable value option? The TSP website (www.tsp.gov) describes it this way:

The G Fund consists exclusively of investments in short-term, nonmarketable U.S. Treasury securities specially issued to the TSP. G Fund investments earn interest at a rate that is equal, by law, to the average rate of return on outstanding U.S. Treasury marketable securities with 4 or more years to maturity. Currently, the maturities of the securities in the G Fund range from 1 day (on business days) to 4 days (over holiday weekends). There is no credit risk (that is, risk that principal or interest will not be paid) for the Treasury securities in the G Fund. They are guaranteed by the full faith and credit of the U.S. Government. Because of the Board's current policy of investing only in short-term securities, there is also no market risk in the G Fund. Market risk is the risk of fluctuations in the value of securities due to changes in overall market rates of interest. If you are uncomfortable with market risk, the G Fund may be the most appropriate investment fund for you. However, G Fund rates of return may well be lower than those of the other TSP funds over the long term. As a result of the G Fund rate calculation and the Board's policy of investing exclusively in short-term securities, investors receive a longer-term rate on short-term securities and at the same time avoid the market risk associated with longer-term securities.[iii]

For federal employees—ranging from park rangers to SEC staff to members of Congress—invested in the option, the G Fund operates as a stable value fund because investors "receive a longer-term rate on short-term securities and at the same time avoid the market risk associated with longer-term securities." This is a concept familiar to 401(k) stable value investors, who have always enjoyed longer term returns with book value liquidity. The major difference is that, unlike 401(k) stable value options, no third-party synthetic GIC provider contractually ensures those benefits in the G Fund; rather, the U.S. Treasury subsidizes the fund by effectively acting as the GIC provider. This subsidy is potentially huge. Consider: a synthetic GIC contract achieves stable returns through a smoothing mechanism that amortizes return volatility over time. If a $70 billion fund used a conventional synthetic GIC contract, the value of the smoothing effect, based on contract fees of five to ten basis points, would be $35 million to $70 million per year. By contrast, the G fund has no such amortizing mechanism; rather, the U.S. Treasury simply guarantees long-term rates on short-term money. In effect, the government subsidy is the difference between short and long-term rates—an enormous benefit that far outstrips the value of conventional synthetic GIC fees.

The table below illustrates the historic GIC-like returns G-fund participants have enjoyed with little volatility:

If the TSP model is followed for the Social Security reforms championed by President Bush, the question is: Will the U.S. Treasury similarly subsidize the entire Social Security investor population-up to 148 million participants according to the Employee Benefit Research Institute, compared to 5 million participants currently in the TSP plan[iv]—by acting as the synthetic GIC provider for personal retirement accounts? If so, no private provider could compete head-to-head with the U.S. Treasury. Given the President's focus on costs and privatization, however, it is far more likely that any reform legislation enacted would authorize a competitive bidding process among private providers for stable value funds within the accounts. Assuming this is the case, the closest analogs for how such a process might work for Social Security accounts are probably the Federal Reserve Deferred Compensation plan (for Federal Reserve employees and the only option available at the federal level other than the TSP) and public plans offered at the state and local government levels.

The federal TSP, at $141 billion in total plan assets, is by far the largest public retirement plan-the next largest public plans dip dramatically to around $11 billion, with Texas Municipal Retirement at $11.6 billion and New York City Public & Teachers at $10.8 billion. Total plan assets go

continued on page 9

Year	G Fund*	Related Securities**
1993	6.14%	6.23%
1994	7.22%	7.29%
1995	7.03%	7.10%
1996	6.76%	6.80%
1997	6.77%	6.80%
1998	5.74%	5.77%
1999	5.99%	6.03%
2000	6.42%	6.42%
2001	5.39%	5.36%
2002	5.00%	4.98%
1993-2002 compound annual rate of return	6.24%	6.27%

** These rates are stated after deducting the administrative expenses of the TSP.*
*** Rates of return were calculated by the Board. These figures are based on the statutory rate of return and are stated without any reduction for administrative expenses.*
Source: http://www.tsp.gov/rates/monthly-history.html

Stable Value to Have a Home in Roth 401(k)s

By Randy Myers

On January 1, 2006, it becomes legal for employers to offer a Roth 401(k) qualified retirement plan to their employees. While it is unclear just how many employers will offer these new investment vehicles, it does appear that stable value investments will play just as big a role in any that are created as they do in traditional 401(k)s.

"Stable value will be just as appropriate an investment for Roth-style contributions as for regular (k) contributions during the accumulation phase of retirement savings," says Chris Bowman, Vice President for Retirement and Investor Services at Principal Financial Group, one of the nation's largest 401(k) plan vendors. "Participants who are less tolerant of market swings, and those who are closer to retirement, will still be very interested in stable value."

Roth 401(k)s were authorized by the Economic Growth & Tax Relief Reconciliation Act of 2001 and are similar in concept to Roth IRAs, which were introduced in 1998. Contributions to a Roth 401(k) are made on an after-tax basis, and, as a consequence, can be withdrawn tax-free. Earnings can be withdrawn tax-free, too, if the participant has maintained the account for at least five years and is at least 59 1/2 years of age, or is taking the distribution upon death, disability, termination of employment, or hardship. By contrast, contributions to a traditional 401(k) plan are made on a pretax basis, but both contributions and earnings are taxable upon withdrawal.

"The Roth 401(k) followed the Roth IRA and the premise that we should not tax any investment earnings," observes Dallas Salisbury, President and Chief Executive Officer of the Employee Benefits Research Institute in Washington, D.C. "That was the bias of (Sen. William) Roth, (the Delaware Republican who sponsored the enabling legislation), and of the current administration."

Any employer who offers Roth accounts must assume that some individuals will be better off paying taxes now on their retirement-plan contributions instead of deferring those tax payments until retirement. "Roth-style contributions inside a 401(k) plan allow people to make choices based on their individual circumstances," says Bowman. "This could encourage some people to save who might not otherwise have done so."

Conventional wisdom holds that Roth 401(k) accounts will appeal principally to investors who expect their income or their income tax rate to be higher after retirement than it is now. But retirement plan provider Vanguard Group notes that the Roth 401(k) also will appeal to workers whose incomes are sufficiently low today that they currently pay no federal income taxes. For them, there is no immediate tax advantage to contributing to a regular 401(k) plan. With a Roth 401(k), though, they eliminate the possibility of paying taxes on their retirement savings once they stop working.

Despite the potential benefits to some workers, many employers are not prepared to offer Roth 401(k)s when January rolls around. Lori Lucas, Director of Participant Research for Hewitt Associates, a human resources outsourcing and consulting firm, says only about a third of the nearly 200 plan sponsors surveyed by her firm late last year planned to add a Roth 401(k) account to their retirement plans anytime soon. By late May of this year, she says, sentiment among plan sponsors hadn't changed much.

Mary Kazan, Group Vice President for Corporate Benefits at apparel manufacturer Phillips-Van Heusen Co., says her company is among those not ready to commit to the Roth 401(k). "We have given it some thought, and at this point we're really not looking seriously at it," Kazan says. "It's not something we think is going to add a lot of value for our employees." She notes that many of Phillips-Van Heusen's employees work

continued on page 10

Stable Value & Social Security

continued from page 8

down from there with only about ten plans topping $3 billion or more in total plan assets.

Stable value funds in public defined contribution plans consist of a wide range of structures. The oldest model sometimes called an IPG is basically a general account GIC like product usually issued by one insurance company. The larger accounts mentioned in this article use either a diversified portfolio of traditional GICs or synthetic GICs (also called "wraps") or some combination.

Excluding Texas Municipal Retirement fund, at $11.6 billion, which is managed in-house with an internal guarantee like the federal Thrift Savings Plan, many of the remaining largest public plans use stable value extensively:

- The NYC Public & Teachers, at $10.8 billion in total plan assets, uses a combination of traditional and synthetic GICs, but with a majority in synthetics.
- The University of California, the next largest public plan at just under $8 billion in total plan assets, uses traditional GICs exclusively.
- The New York State Deferred Compensation plan, with total plan assets of $6.5 billion, uses a combination of traditional and synthetic GICs, but with a majority in traditional GICs.
- Washington State Board, at $5.5 billion in total plan assets, primarily uses traditional GICs.
- California Savings, at $5.1 billion in total plan assets, primarily uses synthetic GICs.
- Ohio Deferred Compensation, also with $5.1 billion in total plan assets, primarily uses synthetic GICs.
- Los Angeles County Deferred Compensation, with $4.2 billion in total plan assets, uses both traditional and synthetic GICs.[v]
- Almost seventy percent of the Federal Reserve's $3.2 billion deferred compensation plan-$2.3 billion-is invested in that plan's stable value option, comprised entirely of traditional GICs.[vi]

In summary, a stable value option within an investment platform for Social Security personal accounts is likely to be based on one of two paradigms (assuming the U.S. Treasury does not subsidize the accounts): (1) the Federal Reserve model, in which a portfolio of one-hundred percent traditional GICs are bid out on a continual basis to ensure diversification; or (2) the synthetic GIC model used in many large state/city plans. The older IPG single issuer model would probably not be considered due to credit, diversification, and transparency concerns.

Stable value is the top choice of federal employees in both the federal Thrift Savings Plan and the Federal Reserve Deferred Compensation plan because it provides attractive returns while insulating investors against short-term market swings. For precisely that reason, it is obvious that stable value, regardless of the delivery platform, should be offered as a choice if Social Security is partially privatized. SVIA

[i] http://www.whitehouse.gov/news/releases/2005/02/20050210-1.html
[ii] www.nelsons.com
[iii] http://www.tsp.gov/features/chapter08.html#sub1
[iv] http://www.ncpa.org/pub/ba/ba443/
[v] Pension & Investments January 24, 2005
[vi] www.nelsons.com

Roth 401(k)

continued from page 9

in factory and warehouse positions that pay near the minimum wage-an income level where it can be difficult to squeeze any savings out of a paycheck.

Other employers who haven't committed to the Roth 401(k) worry about other stumbling blocks, including increased administrative burdens and the challenge of educating participants about the new accounts. Sponsors who offer automatic enrollment in their retirement plans also will have to decide which type of account to open for employees who don't select one on their own-a traditional 401(k) or a Roth.

Adding a Roth 401(k) option to a plan with a stable value option will, at a minimum, cause stable value managers and GIC/synthetic wrap issuers to pay close attention. If the Roth 401(k) stable value option is commingled with the regular stable value option in the plan, then GIC and wrap issuers will likely consider the Roth addition just another source for contributions and thus no added "risk." After all, perhaps the Roth 401(k) contributions will look the same as normal after-tax voluntary participant contributions. However, if the Roth stable value option somehow is a separate option in the plan available for transfers too and from the other non-Roth stable value option, there would likely be competing fund transfer restrictions.

Lucas says many plan sponsors also are concerned that offering a Roth 401(k) could make the retirement savings landscape more complicated for their employees. Behavioral studies have shown that some investors choose not to invest at all when they feel overwhelmed by the number of decisions they must make. In a bid to minimize that problem, retirement plan providers are counseling employers to make the investment options available in the Roth 401(k) the same as those in their traditional 401(k) plan. "We've been advising clients on the importance of narrowing the focus of the decision making to the tax implications," says Lucas. "There is no reason to have different investment options. In fact, we believe having different investment options could lend confusion to the decision-making process."

Not everyone is gun-shy, of course. Salisbury says EBRI will offer a Roth 401(k) to its employees come January 1, assuming its recordkeeper is prepared to handle the paperwork. "Recent reports from the Government Accounting Office and the Congressional Budget Office make it clear that future tax rates will be much higher, and that getting taxes paid now will be a wise thing to do," Salisbury says. He also argues that a Roth 401(k) should prove the smarter option for the many retirement plan investors who make heavy allocations to equities in their accounts. With a regular 401(k), he explains, investors don't get to take advantage of the lower tax rates currently available on capital gains and dividends, since all distributions from a regular 401(k) are taxed as ordinary income. "A Roth would move the tax rate to zero," he says. "For those that put money in their account for retirement and leave it there, a Roth would be better for their equities."

More plan sponsors might jump on the Roth 401(k) wagon, says David Wray, President of the Profit Sharing/401(k) Council of America, if employees, spurred on by the media and financial advisors, start to demand it. "Pressure from employees does have an impact on plan design," Wray says. "We are beginning to see people write about this, and if they say that a certain type of person definitely wants to be in the Roth 401(k),

continued on page 11

New EU Capital Markets Regime to Significantly Impact Issuers of FA-Backed Notes

By Helena Wilner, Credit Suisse First Boston

The European Union ("EU") is in the process of implementing major changes to the rules governing the offering and listing of securities in the EU in an effort to create a pan-European securities market. These Rules will impact the entire funding agreement-backed market and the availability of the product as a future funding source to issuers of such securities. This market represented over $ 34 billion of funding to the insurance industry in 2004.

The EU Prospectus Directive ("PD") will be implemented by July 1, 2005 across all regulated markets in the European Economic Area ("EEA"). The PD governs the content of prospectuses used to offer securities in the EEA, including securities listed on any EU stock exchange. The Transparency Obligations Directive ("TOD"), which is required to be implemented in the EU member states by January 2007, governs the ongoing periodic disclosure obligations of issuers that have offered and/or have listed securities in the EEA. This article briefly describes these new directives as well as the four main alternatives, for non-EU issuers that wish to have continued access to the EU debt markets. The PD and TOD apply to EU-listed EMTN and GMTN programs, as well as any sale of securities (whether off a programme or on a stand alone basis) into an EU member state that is deemed a public offering (under that country's rules).

The PD/TOD rules apply to the Special Purpose Vehicle issuers of the funding agreement-backed notes. Although not specifically referenced in the PD rules, practitioners believe they are likely to apply to the issuers of the underlying funding agreements as well (by analogy to asset-backed and guarantor provisions).

- **Prospective Directive-**The level of disclosure required pursuant the PD depends on whether the issuance is "wholesale" or "retail" debt. Unlike U.S. securities law regulation, which focuses on the nature of the investors (e.g. QIBs for Rule 144A offerings), the PD rules focus on the denomination of the security as a proxy for investor sophistication. Issues with denominations of $50,000 (or its equivalent in any other currency) or greater are considered wholesale, with lesser amounts being deemed "retail".
- **Retail Disclosure-**Financial information (annual and interim) must be prepared in accordance with International Financial Reporting Standards ("IFRS"). Also, a more detailed and increased business description is required than current Luxembourg and London Stock Exchange Rules. In addition, an MD&A section as well as Risk Factors and a 2,500-word summary of the programme will need to be included. It is worth noting that the PD will eventually permit the use of certain jurisdictional GAAPs that the EU considers "equivalent" to IFRS, but the issue of equivalence has not been resolved as of yet. It is

continued on page 11

EU Capital Markets

continued from page 10

expected that US GAAP will be deemed equivalent, while the issue of US Statutory Accounting Principles is less clear (primarily because it is a lower priority to the EU regulators). The EU body which advises the EU Commission ("CESR") has recommended that the EU Commission deem U.S. GAAP equivalent ("the Technical Advice Paper"), but no formal action has been taken. Although recommending equivalence, the Technical Advice Paper highlighted several areas where US GAAP and IFRS differ, and recommended supplementary disclosure on those points. The issue is still open.

- **Wholesale Disclosure-**No reconciliation to IFRS is required; merely a summary of differences between IFRS and the issuer's accounting principles. Other disclosure about the issuer is different from, but not significantly more burdensome than, current London or Luxembourg rules, however a Risk Factors section will be required. The non-accounting changes applicable to wholesale debt will not be significant for U.S. issuers, who already have high levels of disclosure in connection with their U.S. securities activities. In addition, issuers of only wholesale debt are exempt from the requirements of the TOD with respect to ongoing reporting.
- **Home Member State-** Consistent with the theory of the PD that securities admitted to trade in one regulated market be tradable throughout the EU, non-EU issuers will have to select an EU country (a "home member state"). By such selection, the issuer will submit themselves to the securities regulation of such state, including its prospectus approval process and regulations. Because of how the PD is written, certain types of offerings will have the effect of irrevocably selecting a "home member state". Therefore, issuers must be cognizant of this issue in executing future transactions (especially retail).
- **Transparency Obligation Directive-** The TOD applies to securities issued after January 20, 2005. If applicable, it requires annual and interim financial reports to be prepared in accordance with IFRS (subject to the equivalence issue described above), beginning in 2007. Thus, any U.S. issuer with EU listed securities in denominations below $50,000 that are outstanding in 2007 will be subject to this regime.

Alternatives

- Issue unlisted securities. An unlisted issuance which is not made to the public does not trigger the PD or TOD requirements. Two issues to consider with this alternative are market acceptability of unlisted securities and avoiding an inadvertent public offering. Unlisted private offerings can have a minimum denomination as low as $1,000 without triggering the PD and TOD rules.
- Issue wholesale debt only (which may be listed on the LSE or any other EU exchanges). This avoids the most burdensome requirements of the PD and TOD. Other PD requirements will apply, so an issuer choosing this route will still have to file and get approved a new PD compliant MTN offering document with the relevant listing

continued on page 12

Rethinking Retirement: Americans Must Have New Tools to Prepare for Retirement… and a New Definition of Retirement Itself

By Cynthia Hayes, CFA, Retirement Group, Merrill Lynch

A New Way of Looking at Retirement

The most effective solution to retirement income shortfalls may require a complete rethinking of retirement… but Americans are already doing that. A number of studies, including one by Merrill Lynch, have shown that the next generation of retirees is very interested, even excited, about opportunities to work in retirement.

Baby Boomers say they want a phased or cyclic retirement that includes working part time, or moving in and out of the workforce, or starting a business of their own, after their primary career has ended but before stopping work altogether. (See Figure)

By continuing to work, Americans can delay their "normal" retirement date and allow their retirement savings to continue accumulating. Delaying "full" retirement can also increase the retirement income to be received from Social Security and any pension benefits that are due. By continuing to work—for both personal fulfillment and financial reasons—Americans can mitigate the risk of living "too long" and enjoy a new, perhaps more meaningful phase of life.

continued on page 12

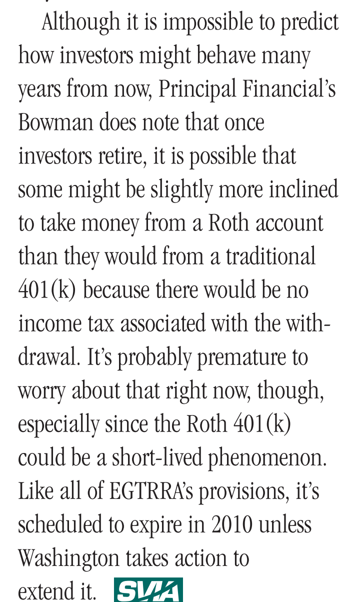
Roth 401(k)

continued from page 10

we'll see what kind of public pressure is brought to bear on plans. Right now, participants have no clue what this is about. But in four months, there will be a drumbeat of publicity."

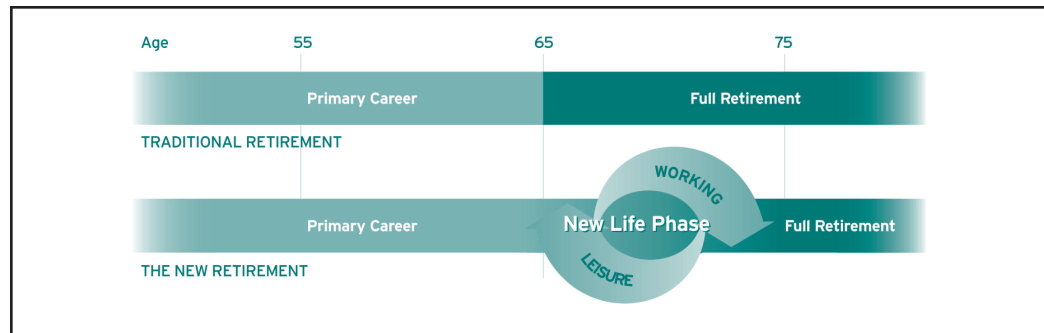
Regardless of how many plan sponsors offer the Roth 401(k)-public school systems and other tax-exempt organizations that offer 403(b) retirement plans can also do it-there is no reason to expect their decisions to have any near-term impact on cash flows into and out of stable value funds. That's because EGTRRA does not allow workers to transfer assets from their traditional 401(k) or 403(b) into a Roth account. Instead, the Roth will be open only to new contributions taken from paychecks earned in 2006 and later. In addition, the benefits of a stable-value investment-steady, principal-guaranteed returns on par with the returns on a short-term bond portfolio-accrue to investors in a Roth account just as they do in a traditional account.

Although it is impossible to predict how investors might behave many years from now, Principal Financial's Bowman does note that once investors retire, it is possible that some might be slightly more inclined to take money from a Roth account than they would from a traditional 401(k) because there would be no income tax associated with the withdrawal. It's probably premature to worry about that right now, though, especially since the Roth 401(k) could be a short-lived phenomenon. Like all of EGTRRA's provisions, it's scheduled to expire in 2010 unless Washington takes action to extend it.



Rethinking Retirement

continued from page 11



Traditional thinking says that there are two phases of retirement planning—accumulation and withdrawal. That model is changing, however, with more and more people indicating a desire to:

- Use current income to accumulate assets and create future income potential during their career, then,
- Spend time growing both personally and financially during this new phase while tapping into their assets as needed, and finally,
- Insure against unexpectedly long life spans or extended elder care needs.

Merrill Lynch views these three phases as an income management continuum. Each of us must manage the income we have, making financial choices and trade-offs throughout our lives. We must set aside income in some stages to create income in others. We must work much of the time to provide income for periods when we will be working less or not at all. There is no substitute for planning and saving.

The bad news is that for most Americans, the burden of planning for retirement income has shifted onto the shoulders of each individual. The good news is that within the now-dominant defined contribution environment, tools such as automated enrolled, and sophisticated-yet-simple advice services are available today to assist in saving for retirement. "Automating" the process of retirement planning, saving, investing and managing is one way to help encourage people to save. Automated steps can include: enrollment, contribution increases, asset allocation, and rebalancing.

It is essential, however, that we explore new opportunities and create an environment where new retirement savings and investment solutions are possible within the structure of retirement programs that exist today.

One solution to help retirees improve their chances of having enough income throughout retirement is for plan sponsors to provide a defined benefit-like opportunity within a defined contribution plan. A deferred, fixed group annuity offered within a defined contribution plan offers pension-like benefits:

- **Reliable income.** Participants know how much retirement income they will receive for each contribution made.
- **Monthly checks in retirement.** While they're working, participants can make either payroll deferral contributions or transfer in funds from their other investment options. These funds can be used to purchase a future stream of income that the participant cannot outlive. Inflation-adjusted payments may also be an option.
- **A wide range of payout options.** Participants can choose income for themselves only, or for themselves and a beneficiary. The income can be for life, or for life with a guarantee period. Participants can also choose to take the proceeds as a lump sum.

American can meet their retirement income needs, with help from policymakers and regulators, plans sponsors and providers. Plan sponsors who give employees planning tools and investment options are also helping to fulfill the sponsor's fiduciary obligation.

It is our obligation as a society and as individuals affected by the nationwide outcome to explore these new opportunities, adopt at least some of their precepts, and utilize the tools provided to ensure adequate income when our working years end completely. SVA

Cynthia Hayes, CFA, is a First Vice President responsible for the Employer Plan Retirement business at Merrill Lynch.

EU Capital Markets

continued from page 11

authority after July 1, 2005. (although most changes are non-substantive).

- List securities on a market outside the EU (e.g. Switzerland, Singapore, Hong Kong). Each of those exchanges has or is putting in place revised listing rules which are similar to existing listing rules in London and Luxembourg. In addition, the Swiss Exchange has approved a relatively simple process to transfer existing listings. These listings will be considered "listed securities" for purposes of European investors. A Brazilian issuer recently opted for a Swiss Exchange listing for a Eurobond.
- Move to an EU "Exchange Regulated Market". The PD and TOD apply to issuers with securities listed on an EU-regulated market. The London Stock Exchange and LSE are in the process of establishing separate "segments" that, while not considered EU-regulated, will be subject to regulation by the relevant exchanges. For technical reasons, this alternative regulation system enables securities to be treated as "listed securities" for purposes of the requirements of most of the European investing community. It is expected that the regulations governing these exchange-regulated markets will be largely those in place today. Market acceptability of such platforms has not been tested as of yet.

There are many issues to consider in addition to those described herein. For example, any alternative which involves an EU listing (e.g. (ii) and (iv) above) could subject the issuer to future changes in EU regulation merely by virtue of having the securities outstanding. Issuers will have to make sure they understand the full implications of the PD and TOD. As the rules are implemented and the alternatives become more established, Issuers will have to keep abreast of those developments as well. SVA