SVIA STABLE TIMES

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In this Issue

SVIA Files Supplemental Comments on Stable Value Contract Study 1
By Gina Mitchell, SVIA

Prudential Economist Sees Continued Strong Case for Bonds 1
By Randy Myers

Insiders Assess Stable Value Issues 1
By Randy Myers

SVIA Elects Four Board Members 1
By Zach Gieske, SVIA

Marketplace Realities: Opportunities for Stable Value 5
By Randy Myers

Finding Retirement Security 6
By Randy Myers

A Dodd-Frank Update: Stable Value Still in Limbo 7
By Randy Myers

New Reporting Requirements Provide Insight into Stable Value Fees 8
By Randy Myers

Meeting the Challenges of a Low Interest-Rate Environment 9
By Randy Myers

Retirement Readiness: A Global Challenge 10
By Randy Myers

A Consultant's Perspective on Stable Value 11
By Randy Myers

The Impact of Managed Accounts on Stable Value Funds 11
By Randy Myers

Stable Value and the Small-Plan Market 12
By Randy Myers

DOL Continues to Refine ERISA Rules and Regulations 13
By Randy Myers

The Fiscal Cliff: Where Politics and Economics Meet 14
By Randy Myers

Apples to Apples 15
By Jane Marie Petty, Galliard Capital Management

Highlights from AARP's "Boomers and the Great Recession: Struggling to Recover" 15
By Gina Mitchell, SVIA

Portrait of a Plan Participant 17
By Zach Gieske, SVIA

Moody's Fires a Shot Across the Bow of U.S. Treasuries by Considering Downgrade – Implications for Stable Value Funds 18
By Marijn Smit, Transamerica Stable Value Solutions

SVIA-LIMRA Stable Value Sales and Assets Survey 23
By Gina Mitchell, SVIA

SVIA Quarterly Survey 24
By Gina Mitchell, SVIA

SVIA Files Supplemental Comments on Stable Value Contract Study

By Gina Mitchell, SVIA

On November 1, 2012, SVIA filed written comments with the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC). The Commissions reopened their original August 25, 2011, request for information that covered 29 questions on October 2, 2012. The Commissions reopened the request for information since the earlier comments did not have the benefit of the final swap definition rules and the insurance product test exemption, which is included in

continued on page 2

Insiders Assess Stable Value Issues

By Randy Myers

Stable value "insiders" are a diverse lot. Among others, they include stable value asset managers and contract issuers, banks and insurance companies, retirement plan sponsors and retirement plan consultants. All share the same overarching goal of providing consistently positive returns for retirement plan participants, yet each views the asset class from a slightly different perspective. In a wide-ranging panel discussion at the 2012 SVIA Fall Forum, several of them discussed how they view the stable value industry today and pinpointed issues that are top of mind for them.

Maureen Scaduto, plan sponsor

Maureen Scaduto is associate director for the Cultural Institutions Retirement System in New York City, a multi-employer system covering about 10,000 active and 10,000 former employees of cultural institutions and day care

continued on page 3

Prudential Economist Sees Continued Strong Case for Bonds

By Randy Myers

Just a year and a half ago, investors were worried about what a rising interest-rate environment would do to bond portfolios. After all, interest rates were already at extraordinarily low levels in many sectors of the fixed-income market, and it seemed that rates had nowhere to go but up. Rising interest rates, of course, translate into falling bond prices.

Eighteen months later, fears about rising rates are muted, Robert Tipp, managing director and chief investment strategist for Prudential Fixed Income Management, told participants at the SVIA's 2012 Fall Forum. The outlook for the bond market remains favorable, he said, with rates for the long Treasury bond likely remaining

continued on page 2

SVIA Elects Four Board Members

By Zach Gieske, SVIA

While not nearly as controversial as the national elections, the SVIA Board of Directors election held in October 2012 featured incumbents both retaining and losing seats, and the unanimous approval of a plan sponsor running unopposed. The field of candidates was especially strong this year with seven highly qualified candidates, three of them incumbents, running for only three service firm seats. The incumbents were Pete Chappelear of JP Morgan Asset Management, Jim King of Prudential Retirement, and Marijn Smit of Transamerica Stable Value Solutions. They were challenged by Nick Gage of Galliard, Bob Madore of T. Rowe Price, Jim McKay of Columbia Management, and Jessie Mohan of The Bank of Tokyo Mitsubishi UFJ, Ltd. The turnout

continued on page 5

Strong Case for Bonds

continued from page 1

stable in a low range of about 3 percent to 3.5 percent.

That favorable outlook is attributable in part, Tipp explained, to Federal Reserve monetary policy. In addition to disclosing that it plans to keep its target Federal Funds rate near zero percent through mid-2015, the Fed also recently embarked on a massive program to purchase additional agency-backed mortgage securities at a pace of $40 billion per month, adding further pricing support to that sector of the market. That should continue to depress yields in other fixed-income sectors, he said.

Tipp outlined several other reasons why the outlook for the fixed-income markets remains stable:

Historical precedent. Historically, Tipp said, long-term interest rates in countries with a stable monetary framework, a reasonable amount of security and a solid institutional framework have held near 4 percent the vast majority of the time. One reason? "When you have disasters," he observed, "the only thing that goes up is long government bonds. They're the only storehouse of value."

Real estate softness. There has been encouraging news on the housing front lately. Home prices are showing signs of stabilizing, and a growing U.S. population is expected to continue to drive household formations and hence the rental market. Still, Tipp said, there is a lot of housing inventory sitting on the sidelines while owners wait for the right time to put up for-sale signs. So while the nascent housing recovery is good for the economy, it is not a problem for the Fed's easy monetary policy. "This is not a boom that needs to be headed off at the pass with higher rates," Tipp said. "The Fed is thrilled to see this."

High debt levels. While the U.S. economy is growing at about a 2 percent annual rate, that's hardly exorbitant. And high debt levels in both the private and public sectors will continue to dampen economic growth, easing pressure on the Fed to push interest rates higher anytime soon.

continued on page 3

SVIA Supplemental Comments

continued from page 1

these rules. The comment period, which was scheduled to close on November 2, now closes on December 31, 2012, according to the CFTC's website. To date, 18 entities including the SVIA have filed comments, which is a little more than half of the number of comments received during the first request.

In SVIA's November 1st comments, the Association made two additional points. SVIA focused on the logic that the Commission used to define a swap and exempt certain insurance products and commercial agreements from the swap definition to further explain why stable

To learn more about the Dodd-Frank Act and the stable value study, please see "A Dodd-Frank Update: Stable Value Still in Limbo," by Randy Myers, which is in this issue.

value contracts do not fall within the swap definition. The SVIA also explained in the seven page supplemental letter why stable value contracts do not fit into the regulatory framework that the Dodd-Frank Act and the Commissions have structured for over-the-counter swaps.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) requires the Commissions jointly to conduct a study to determine if stable value contracts used exclusively in defined contribution plans fall within the definition of a swap. Further, the Dodd-Frank Act requires that the Commissions not only determine if stable value contracts are swaps but also requires the Commissions to determine if an exemption from regulation as a swap is in the public interest, should the Commissions determine that stable value contracts fall within the technical definition of a swap. Until the Commissions make these decisions, stable value contracts are not swaps. Additionally, the Dodd-Frank Act says that the Commissions' decisions will apply prospectively to stable value contracts.

Although the Dodd-Frank Act required the Commissions to conduct the study within 15 months of the passage of the Act, which has long since passed, it is still hard to predict a timetable for the Commissions' actions. The reopening of the comment period demonstrates that the CFTC and SEC are taking a very deliberative and thorough approach. The extension of the comment period (the original deadline was November 2, which was in the middle of Sandy, one of the worst tropical storms/hurricanes that travelled the length of the East Coast) through the end of this year also indicates it is unlikely that the study team's report and/or a decision regarding stable value contracts will be made this year. SVIA

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Strong Case for Bonds

continued from page 2

Persistent unemployment. Unemployment is down significantly from its post-recession highs, at 7.9 percent in early November. But that's still well above the Fed's target. It could be worse than it appears, too, since many people have dropped out of the workforce and aren't being counted among the unemployed. This argues for continued accommodative monetary policy, Tipp said, as does decelerating wage growth.

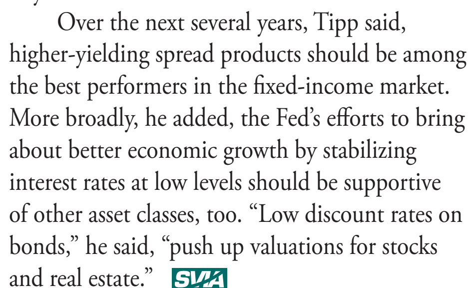
Demand for money remains modest. Demand for money is ultimately what pushes up interest rates, Tipp said. While demand has increased since the financial crisis, he said, it remains extremely muted. "To the extent there is net demand for money from government and the private sector," he added, "the Fed is soaking it up."

The U.S. dollar remains strong. While some people worry about the dollar losing value, Tipp said the U.S. currency has never been perceived as a better storehouse of value than it is now. He pointed to the strength of the U.S. Treasury market as evidence. "U.S. fixed income markets are the soundest in the world, the most coveted, safest, most liquid, broadest and deepest," he said. "Even during the U.S. financial crisis, the value of the dollar shot up. We're the flight-to-safety currency."

High cash reserves. Institutions and individuals have higher levels of cash reserves as a percentage of GDP than they have at any time since 1980, except for a brief period at the height of the 2008 financial crisis, Tipp observed. That provides a strong backdrop of support for the fixed-income markets.

Risk aversion. Institutions and individuals alike remain highly averse to risk in the wake of the financial crisis, which continues to keep them buyers of fixed-income assets.

Over the next several years, Tipp said, higher-yielding spread products should be among the best performers in the fixed-income market. More broadly, he added, the Fed's efforts to bring about better economic growth by stabilizing interest rates at low levels should be supportive of other asset classes, too. "Low discount rates on bonds," he said, "push up valuations for stocks and real estate."



Insiders Assess Stable Value

continued from page 1

centers in the New York City area. In addition to offering a traditional pension plan and a life insurance plan, the organization operates a $400 million 401(k) plan that includes a stable value fund. Perhaps because that plan is the only savings vehicle many of its participants have, Scaduto said, capital preservation is important to them, and they collectively have about 60 percent of their plan assets invested in the stable value option.

Scaduto said that, in hindsight, her organization recognizes that it didn't understand stable value funds very well prior to the 2008 financial crisis, but she said it has a much better understanding of them today. Among the issues she and her colleagues are paying attention to are the growing complexity of stable value contracts and the tighter investment guidelines being imposed on stable value managers by wrap issuers. They're also mindful of the amount of wrap capacity available in the marketplace, and concerned about the possibility that wrap issuers may try to lengthen the standard 12-month put option that applies to plan terminations in pooled funds. They're concerned, too, she said, about the persistently low interest-rate environment and what that might do to their stable value fund's market-value-to-book-value ratio and its crediting rate—especially as the crediting-rate cushion provided by prior market-value gains begins to fade away.

William McCloskey, insurer and wrap issuer

As a vice president and head of the Institutional Stable Value business at Prudential Retirement, William McCloskey leads all daily operations of Prudential's stable value wrap and traditional GIC businesses. Addressing Forum participants, McCloskey said that while the stable value industry has negotiated the post-financial crisis years well it still faces many challenges, which include the continuing need to bring new wrap capacity to the marketplace and managing what looks to be an extended period of low interest rates. Continued low rates, he said, are likely to gradually erode market-value-to-book-value ratios of stable value funds, making them riskier for wrap issuers. "They (low rates) will challenge our ability to guarantee investment strategies we were able to guarantee when market-to-book ratios and interest rates were higher," he emphasized.

McCloskey said there also remains a need for the stable value industry to do a better job of educating retirement plan sponsors and plan participants about the value proposition that stable value funds offer. "When I see plan sponsors making decisions to get out of stable value," he said, "I think it reflects a lack of understanding rather than, necessarily, good decision-making."

Melissa Rowe, bank wrap issuer

Melissa Rowe is a vice president in the Stable Value Group of State Street Bank's Structured Products Division, where she has responsibility for institutional client relationship management, including underwriting, pricing and product management. She said one of the biggest challenges facing stable value providers is the growing popularity among plan sponsors of re-enrolling participants in their plans. As part of that process, sponsors often automatically direct future participant contributions into the plan's qualified default investment alternative, which in many cases is a target-date fund. That can have the effect of increasing cash flows out of the plan's stable value fund. "We understand why the sponsor is doing something like that, but it becomes an event for the plan and, therefore, for the stable value fund," Rowe observed.

Rowe said her firm has had experience with two or three sponsors conducting re-enrollments so far in 2012, after not seeing it at all in prior years. "Where it's happened," she says, "we've been working with sponsors and investment managers to determine how it affects the stable value fund and its long-term viability."

Adam Silver, bank wrap issuer

As director of the 401(k) Stable Value Group at Royal Bank of Canada, Adam Silver is responsible for the bank's stable value wrap business. He said that generally speaking, the momentum for the business has been more positive this year than in years past. "Most of the troubled accounts that existed around the industry have been diffused or worked out, and I think

continued on page 4

Insiders Assess Stable Value

continued from page 3

that's allowed for a little bit more optimism and renewed growth, and that's good," he said.

Silver reiterated that the low interest-rate environment, and expectations for continued low rates, will prove challenging for the stable value industry. "It's accelerated by the fact that everyone wants to position themselves a little shorter down the yield curve, which only amortizes gains away more quickly," he said. "That puts us in a position where we're ultimately going to be faced with a rising rate environment, with all the gains long since amortized away. It's something we're sensitive to, and looking at closely."

Silver said he was glad to hear during other sessions at the SVIA Fall Forum that plan sponsors are asking more questions about stable value and getting a better understanding of the product. He theorized that one of the main reasons sponsors have been frustrated with new requirements handed down by wrap issuers lately is poor communication between sponsors, managers, wrap providers and other parties involved in the product. "The more that people understand the product," he said, "the better it is for all of us."

John Axtell, investment manager

As managing director and head of the Stable Value Management Group at DB Advisors in New York, John Axtell is squarely positioned between the interests of plan sponsors and wrap issuers. He described the industry's overarching challenge right now as one of finding the right tradeoff between wrap issuers' desire to control risk and plan sponsors' waning tolerance for the measures wrap issuers are pushing to accomplish that.

By way of example, he noted hearing anecdotally that some wrap issuers are interested in having stable value managers limit the duration of stable value portfolios to as little as three years. "That creates anxiety for us," he said. "A lot of funds have a significant allocation to the (Barclays) intermediate aggregate (fixed-income) benchmark, which currently has a duration of about 3.4 years and can extend out to four years, and even a little bit in excess of that historically. My perception is that there is a pretty strong preference among plan sponsors and their consultants to keep that intermediate allocation and not bring the duration for the whole portfolio down below three years."

The reason, he said, is clear: the intermediate aggregate index historically has offered a return advantage over benchmarks with shorter durations. He said his firm modeled returns going back 10 years for a wrapped version of the intermediate aggregate index and the Stable Income Market Index, which has a duration of about 2.5 years. Over that time period, he said, the returns for a wrapped intermediate aggregate index exceeded those for the SIMI by about 50 basis points per year. Today, he said, the yield advantage remains about the same.

Axtell said sticking with a longer-duration benchmark offers other advantages, too, such as being able to provide better diversification through a larger universe of investable securities, and perhaps having access to more supply further out on the yield curve, since so much demand is currently concentrated at the shorter-end of the curve. "And, I think, plan sponsors and investment consultants have a perception there is more opportunity for a manager to add value by having the latitude of, for example, an intermediate aggregate versus a shorter strategy," he said. Continued pressure on this front, he predicted, could test the tolerance sponsors have for more changes in stable value funds.

Axtell also echoed the idea that the stable value industry should come together to produce educational materials for retirement plan participants explaining the benefits of stable value products.

Tony Luna, investment manager

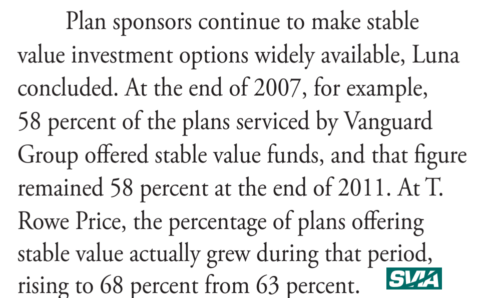
Tony Luna is a vice president of T. Rowe Price Group, Inc. and its affiliates and a portfolio manager in its Fixed Income Division, specializing in stable value portfolios and their underlying fixed-income strategies.

Like several of his colleagues, Luna observed that the continuing low interest-rate environment will be a challenge for the stable value industry, especially insurance companies. "The longer rates stay low," he said, "the more pressure there could be on insurance companies, especially those that have large exposure to variable-annuity products." He said low rates ultimately could pressure credit ratings of the insurance sector.

Regarding stable value portfolio durations, Luna said he finds it punitive to be shortening duration in the current investment climate, given how steep the yield curve is. He observed that stable value managers are in some cases being forced into making minimum allocations to asset classes they may prefer to underweight or not own at the moment, including U.S. Treasuries and agency bonds. These types of securities offer lower yields and could be the most negatively impacted by rising interest rates.

Luna presented statistics indicating that despite the challenges it's faced since the 2008 financial crisis, the stable value industry continues to grow as investors seem to be looking for attractive yields and lower volatility. Since 2008, he said, there appears to be an allocation shift as fixed income funds have seen strong demand and taken in about $1 trillion in new cash flow. During that same time, equity funds, U.S. and international combined have taken in only $150 billion.

Plan sponsors continue to make stable value investment options widely available, Luna concluded. At the end of 2007, for example, 58 percent of the plans serviced by Vanguard Group offered stable value funds, and that figure remained 58 percent at the end of 2011. At T. Rowe Price, the percentage of plans offering stable value actually grew during that period, rising to 68 percent from 63 percent. SVIA



SVIA Board Elections

continued from page 1

reflected the high level of interest in the election, with 93 percent of voting members, 62 out of 67, casting ballots.

Jim King, an incumbent, received the most votes with 76 percent of the voting members supporting him. Jim was finishing his first year in a two year term as Chairman of the Board when his seat came up for reelection and he decided to run for the sake of transparency and simplicity. Jim brings a vast amount of experience with stable value funds to the Board and has overseen a growth of over 500% in Prudential's stable value business during his 10 years with the company. In addition to serving the Association as Chairman, Jim furthers the Association's goals by contributing to industry dialogues on capacity and on the challenges of the pooled fund market, and by leading educational initiatives for the plan sponsor and consultant communities through Prudential-sponsored webinars and events. He is also a common fixture at SVIA conferences; he opened the 2012 Fall Forum and Spring Seminar and closed the 2011 Fall Forum. In his previous role as head of the Communications and Education Committee, Jim helped lead Association communications on the Dodd-Frank legislation which culminated in the Association's submission of information to the CFTC and SEC on the stable value contract study. Prior to that he oversaw SVIA's response to Senator Kohl's inquiry into stable value, and he continues to serve on SVIA's *Stable Times* Editorial Board.

Marijn Smit was also elected to a second term with 58 percent support, and will continue his work as chair of the Communications and Education Committee. Marijn has been a constant resource for the Association, bringing his expertise from Transamerica Stable Value Solutions—a leading provider of synthetic GICs with around $60 billion in stable value products. Marijn has focused on a number of important issues during his time as chair of the Communications and Education Committee, including addressing capacity constraints in the industry and the implications of Dodd-Frank. He has also worked to improve and update the *Stable Times* publication and has ensured that SVIA responds quickly and efficiently to all media matters.

Nick Gage, receiving 52 percent of the votes cast for the third open position, was the only non-incumbent to win a seat on the Board, and though this is his first term on the board he has been serving on the Data and Research Committee for some time. Most recently, Nick has worked with the Data and Research Committee to ensure a consistent implementation of stable value fund reporting under the Department of Labor's new disclosure requirements. He believes the SVIA plays an important role in facilitating collaboration not only among members, but among all those in the industry in order to address the challenges and benefit from the opportunities ahead. In addition to heading Galliard's Client Portfolio Analysis team which is responsible for the portfolio strategy of Galliard's separate account clients, Nick assists with servicing those clients. He is also a member of the portfolio management team for Galliard's flagship stable value collective trust fund and he serves on committees responsible for manager oversight and investment contract review. Nick has been an active participant in SVIA activities since joining Galliard, continuing the company's trend of SVIA involvement since the inception of the Association.

Joe Veeneman has also joined the Board as an unopposed and unanimously confirmed plan sponsor who will be continuing the IBM legacy as current Board member Ed Adams steps down. Ed Adams, CFA, is the manager of DC strategy at IBM and is removing himself from the board after his second term due to the fact that his responsibilities have been shifting away from stable value and more towards DC overall. Joe, also a CFA Charterholder and member of the CFA Institute, currently works as a portfolio manager for IBM Retirement Funds. He manages the fixed income and commodity asset classes, working with their $10 billion stable value fund which is part of a $40 billion Defined Contribution Plan. IBM has been a staunch supporter and active member of SVIA for many years, and Joe is looking forward to providing a plan sponsor's perspective for the stable value community and helping to address the issues impacting the industry.

This is a tumultuous time for stable value funds with increasing press and tightening regulations on the financial industry, yet also a great opportunity. The current economic climate has highlighted the strengths of stable value funds and generated increased interest from plan sponsors and participants. Now more than ever SVIA needs strong and capable leadership. The Association is thankful for members on and off the board who contribute their expertise, guidance and financial support. SVIA

Marketplace Realities: Opportunities for Stable Value

By Randy Myers

Addressing the SVIA's annual Fall Forum 2012 in Washington, D.C., Eric Levy, senior vice president, Product Solutions Management for Lincoln Financial Group, declared that for many retirement plan participants, the investment landscape now appears dramatically more risky than it did five years ago. Following the stock market crash that began in 2007, he noted, nearly a third of the participants in defined contribution plans who were nearing retirement age either reallocated money to more conservative investments and/or postponed their retirement date.

Gen X:
20%
Have allocated 0% equities in their 401(k) investment porfolio

Stable value products already play a meaningful role in defined contribution plans. The approximately $646 billion held in stable value funds accounts for about 14 percent of the total assets in those retirement savings plans. But given the evolving challenges facing investors and retirement plan sponsors, the stable value industry could do more to ensure that its products remain an attractive investment option for retirement plan participants, said Levy.

It isn't only those workers in their 50s and 60s who have become more conservative. About

continued on page 6

Marketplace Realities

continued from page 5

20 percent of the 55 million “Generation X” workers born between 1965 and 1977 have no money allocated to equities in their defined contribution plans. And 40 percent of the 77 million Americans in Generation Y, born between 1978 and 1995, agree that they will “never feel comfortable investing in the stock market.”

This would seem to present an opportunity for the stable value industry, which offers a conservative investment product providing principal preservation and stable returns. But, Levy said, to fully capitalize on that opportunity the industry will have to do a better job of explaining to investors, in plain English, what stable value is and how it can help them achieve their retirement savings goals. Educational programs provided by plan providers have changed over the past decade, Levy acknowledged, but he contended that they haven’t evolved enough to demystify for plan participants what can be a fairly complex product.

Gen Y:

40%

Will never feel comfortable investing in the stock market.

In addition to doing a better job of educating plan participants, Levy said the industry also will have to do a better job of making plan sponsors aware of stable value, and of helping plan sponsors understand its benefits and challenges—particularly among small and mid-size plans. The industry also needs to differentiate stable value from its competitors, he said, especially as other products are introduced that attempt to manage investment-return volatility. He also advised that it should work hard to make sure stable value products are included in asset-allocation solutions offered to 401(k) plan participants, such as target-date funds, managed accounts and advice platforms.

Finally, Levy said, the stable value industry may want to consider asking the Department of Labor to reconsider what qualifies as a “qualified default investment alternative,” or QDIA, to include stable value products. Right now, target-date funds are by far the most popular QDIAs. The time for revisiting the issue could be right, he said, given that “target-date funds, off-the-shelf, have not necessarily worked to the advantage of (plan) participants, and given that we (the stable value industry) have created some good returns on a risk-adjusted basis.” SVIA

Finding Retirement Security

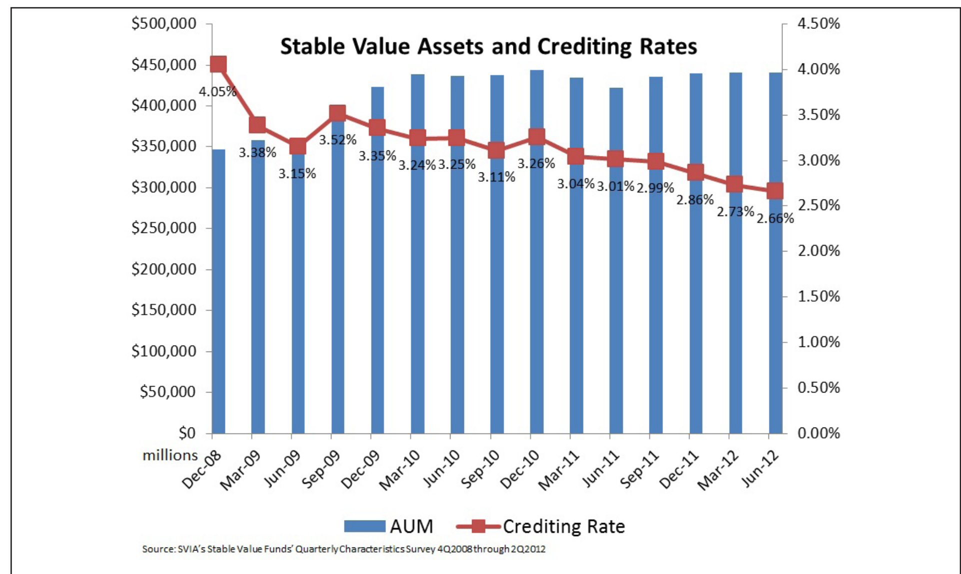
By Randy Myers

Stable value is in a new stage of growth and stability.

At the height of the financial crisis in the last quarter of 2008, stable value funds held about $347 billion of the assets in defined contribution plans. That number rose to $423 billion by the end of 2009 or 22 percent as investors sought out less volatile investment options. By the end of the second quarter of 2012, investments in stable value had risen to $441 billion, or 27 percent.

“This data demonstrates that plan participants knowingly chose stable value and with equal measure have stuck with stable value,” SVIA Chairman James King told SVIA members at the opening of the organization’s 2012 Fall Forum. “Retirement plan participants like the safety and security that stable value provides. During the financial crisis, when U.S. Treasury bonds were the world’s choice of a flight-to-quality investment, stable value funds were the security blanket for defined-contribution-plan investors that enabled them to sleep at night.”

King noted that while the Standard & Poor’s 500 stock index lost about 40 percent of its value from the third quarter of 2008 through the first quarter of 2009, stable value funds on average returned about 4 percent for their investors. While some younger retirement-plan participants have seen some of the value of their equity holdings recover, he added, the stock market crash “was tragic for near-retirees or those in retirement who had significant exposure to riskier assets.” By contrast, he noted, “Those who were in stable value didn’t lose anything.”



King observed that retirement plan participants in their 20s allocate about 8 percent of their assets to stable value, on average. Allocations increase as participants grow older, with those in their 60s holding about 28 percent to 29 percent of their assets in stable value.

continued on page 7

A Dodd-Frank Update: Stable Value Still in Limbo

By Randy Myers

Stable value wrap contracts aren't considered swap contracts under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010—and they won't be unless the Commodities Futures Trading Commission (CFTC) and the Securities Exchange Commission (SEC) determine that stable value contracts are swaps.

A major goal of the Dodd-Frank Act was to bring greater transparency and regulatory oversight to over-the-counter derivatives, or, in the language of the legislation, "swaps." The statute's definition of a swap was broad, however, threatening to encompass products that many observers felt were never intended to be subject to the legislation. Perhaps the most prominent example: stable value contracts, which back the contract-value guarantees offered by stable value funds.

In a late bid to resolve the issue, Congress included language in the legislation requiring regulators at the SEC and the CFTC to study whether stable value contracts should fall under the statute's umbrella. If the study concluded they did not, that would be the end of the matter. If it found that stable value contracts should qualify as swaps, however, Congress also gave the regulators express authority to exclude them if doing so would be "appropriate" and in the public's best interest.

"The study was supposed to be finished about a year ago, but it hasn't been completed," attorney Anthony Mansfield, a partner with the law firm of Cadwalader, Wickersham & Taft, told participants at the 2012 SVIA Fall Forum. But he called the study mandate and the authority to exclude stable value contracts from the legislation a "very, very powerful tool" in the current political climate.

Mansfield said that if regulators eventually decide that stable value contracts qualify as swaps, they would then have to propose rules for how to regulate them, put those proposed rules out for comment, and ultimately issue final rules. Only then would stable value contracts be subject to Dodd-Frank, he emphasized. Until then, they remain exempt.

For now, Mansfield said, regulators appear to be caught up in more pressing matters. "I think we have always been positioned last in line, and often that is not a good thing," he said. "But in this case I've taken the view that I think it is a good thing that stable value contracts are not a pressing issue for the Commissions—particularly since the Commissions must determine first if stable value contracts are swaps and if these contracts should also be regulated as swaps."

No one can predict with certainty how the matter will ultimately be resolved, of course, but, Mansfield said, "I continue to think there is a bias among regulators to conclude that stable value is not a swap and cannot be regulated as a swap."

He noted that the stable value industry has made a concerted effort to educate regulators about their product. "I have a degree of comfort that we've appropriately managed this process to date," he said. "We will continue to argue that stable value contracts are not swaps, and identify for regulators why they are not." SVIA

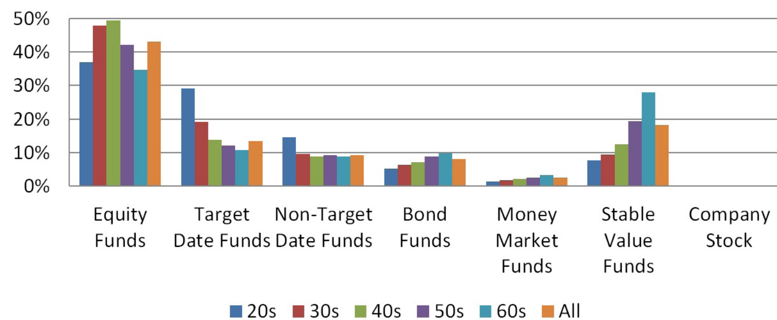
Finding Retirement Security

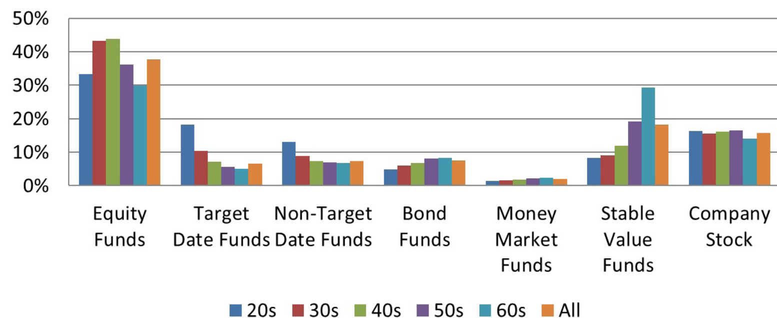
continued from page 6

Although crediting rates on stable value funds have edged lower as short-term interest rates have declined over the past few years, King said, they remain positive. And stable value funds themselves, he added, have become "healthier than ever."

"That's a great accomplishment," he said, "helped somewhat by the market but also by good management of underlying assets. As an industry, we are building a solid foundation for

continued on page 8

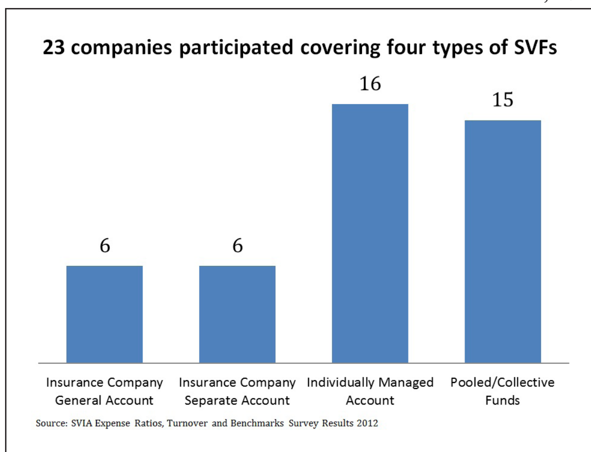




New Reporting Requirements Provide Insight into Stable Value Fees

By Randy Myers

Stable value funds that are managed as individual accounts for a single retirement savings plan have the lowest expense ratios in the stable value marketplace, a new survey from the SVIA confirms.



Under new Department of Labor (DOL) regulations, defined contribution plans this year began reporting to their plan participants detailed information about the costs of the investment options in their plans. The SVIA recently surveyed 23 stable value managers to find out what they disclosed about the costs associated with their products, and how they calculated them. The survey covered stable value funds that collectively had $522.8 billion in assets as of June 30, 2012.

For the 16 individually managed accounts covered in the survey, reported expense ratios ranged from a low of 0.25 percent to a high of 0.50 percent and averaged 0.34 percent. For the 15 pooled funds, also known as collective funds, ratios ranged from a low of 0.25 percent to a high of 0.81 percent, averaging 0.42 percent. The survey found that the six separate accounts by insurance companies covered in the survey reported an expense ratio that ranged from a low of 0.35 percent and a high of 0.72 percent, with an average expense ratio at 0.49 percent. (Expense ratios are not applicable to insurance company general-account products.)

LeAnn Bickel, manager of stable value client service and contract administration for INVESCO Advisors Inc., disclosed the findings at the SVIA's 2012 Fall Forum in Washington, D.C. She noted that under the new DOL regulations, fund managers also are required to provide a benchmark against which to compare the performance of their funds. For stable value managers, the most popular benchmark is the 3-month U.S. Treasury bill index, she noted. It was used by 19 of the survey respondents.

Some survey respondents reported utilizing more than one benchmark. Six listed a 1-3 year government/credit index, and two reported using a 1-5 year government/credit index. In addition, one manager reported using the Barclays Intermediate Aggregate Index, and one manager reported using the Barclays Stable Value Income Market Index.

The SVIA survey also asked managers to disclose how they calculated the turnover ratios they reported for their funds, another requirement of the new DOL regulations. Turnover is a common metric used by mutual funds and similar investment vehicles to indicate how often their underlying investments are replaced with other holdings. In general, low-turnover funds are viewed as being more efficient than high-turnover funds because they incur fewer transaction costs. But determining how to calculate a turnover ratio for a stable value fund isn't straightforward. DOL guidelines specify that it be calculated as the lesser of buys and sells within the fund, divided by average market value. But as Stephen LeLaurin, senior portfolio manager for INVESCO Advisors Inc., explained, there are several ways to interpret what constitutes a buy and a sell.

Some stable value managers argue that for purposes of calculating turnover, stable value funds are like money market funds, which are exempt from reporting a ratio. Four stable value funds said that's what they did, either not reporting a ratio or reporting a ratio of zero.

Others contended that the turnover ratio should be based on the purchase and termination of the wrap contracts backing a fund's book-value withdrawal assurance. LeLaurin said he knew of one plan sponsor using that approach.

Still another option is to base the ratio on the number of deposits and withdrawals into and

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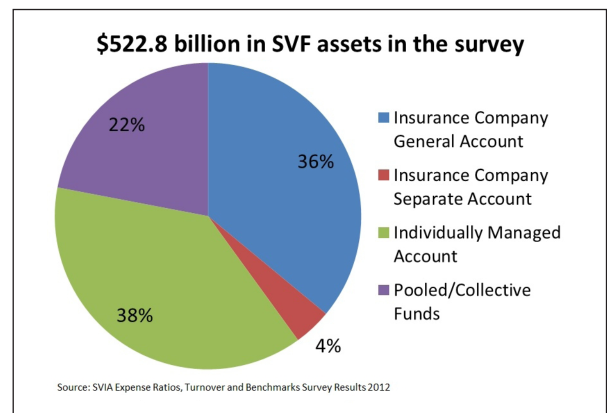

Finding Retirement Security

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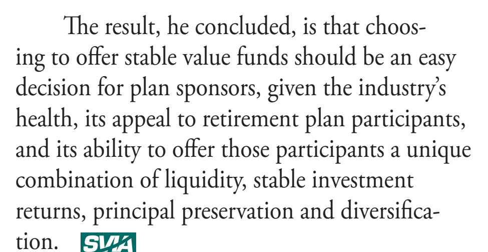
growth. We still have issues and challenges, but we will continue to build and continue to grow a stronger, more dominant asset class."



The result, he concluded, is that choosing to offer stable value funds should be an easy decision for plan sponsors, given the industry's health, its appeal to retirement plan participants, and its ability to offer those participants a unique combination of liquidity, stable investment returns, principal preservation and diversification. SVIA

Meeting the Challenges of a Low Interest-Rate Environment

By Randy Myers

When it comes to interest-rate risk, the focus for the stable value industry has always been on rates rising steeply or suddenly, which would be a major change from today's sustained low rate world. The issue for stable value is whether retirement plan participants would flee the asset class in favor of money market funds, where returns to investors tend to immediately follow in a rapidly rising rate environment.

Today's low interest rates are the more immediate concern, however. Short-term rates have been hovering at historic lows for the past year, and the Federal Reserve has indicated that it plans to keep them low at least until mid-2015. Over time, low rates drive down the crediting rates that stable value funds promise to their investors. Many in the industry have been wondering just how low they might go over the next few years, and how that might impact stable value's appeal to retirement plan participants.

For answers, analysts at New York Life Investment Management LLC looked at how stable value crediting rates have held up over the past six years as short-term interest rates have fallen to historically low levels, and projected how crediting rates might fare if interest rates stay low for the next few years. Aruna Hobbs, managing director and head of Stable Value Investments for New York Life Investment Management LLC, presented the findings at the 2012 SVIA Fall Forum.

Over the past six years, Hobbs noted, the yield on the 5-year Treasury note has fallen more than 400 basis points to less than 1 percent. During that same period, the yield on the investment portfolios underlying stable value funds, as measured by the Wrapped Barclays Stable Income Market Index, also declined, but by less than treasury yields: from about 2.8 percent to about 1 percent. Crediting rates for stable value funds fell much less, though, going from about 2.8 percent to roughly 2.5 percent.

Crediting rates fell less than interest rates, Hobbs said, in part because of the way crediting rates are calculated. They benefit from the amortization of prior market-value gains recognized in stable value funds' underlying investment portfolios. In effect, in a falling rate environment, those gains cushion declines in the crediting rate.

That cushion should continue to moderate the decline in crediting rates between now and 2015 even if yields on stable value portfolios continue to decline, Hobbs said. Her firm's analysis shows that even if those yields fall to just under 0.5 percent by July 2015, stable value funds should still be offering crediting rates of about 1.25 percent. And their market-value-to-book-value ratios should hold up too, standing at about 102.2 percent at the end of the period. "A continuing pattern of lower interest rates," she concluded, "doesn't present a significant or material risk to us."

Hobbs and her colleagues also looked at what would happen in more unusual circumstances—say, a credit impairment event, such as a default or downgrade of investment securities in the fund's portfolio. Hobbs noted that due to the cushioning effect of prior market gains, established stable value funds would fare better in the aftermath of a credit impairment event than new stable value business issued at par—with a market-to-book ratio of 100 percent.

"Does this provide an analysis of the entire range of plausible and possible outcomes?" Hobbs asked. "No. But if we're talking about pre-existing business with healthy market-value-to-book-value ratios, especially if it was business issued over six to eight years ago, it does show that type of contract can sustain pretty long periods of low interest rates. In the case of an impairment event, the ultimate impact would depend on the magnitude of the event, the level of cushion in the portfolio, and other factors."

Despite that generally positive assessment, the low interest-rate environment does present challenges for stable value managers, said Jennifer Gilmore, senior portfolio manager and head of stable value portfolio management for INVESCO Advisors Inc. One is to find investments with sufficient yield without running afoul of investment guidelines. With lower yields, she observed, funds also have less cushion to absorb wrap, investment management and administrative fees. Finally, she said, new portfolios are difficult to fund where the existing market-value-to-book-value ratio cannot support a higher crediting rate.

Nick Gage, head of the Client Portfolio Analysis team at Galliard Capital Management, said that despite the challenges of a low rate environment, stable value portfolios remain healthy. He emphasized that Association statistics supported the strength and resiliency of stable value. SVIA

New Reporting Requirements Provide Insight into Stable Value Fees

continued from page 8

out of wrap contracts; eight survey respondents endorsed that approach.

Two firms said they based the ratio on participant cash flows into and out of their stable value funds. And at least one fund said it also partly considered buys and sells into and out of its fund's underlying collective trust funds.

Finally, nine respondents said they chose to drill down to the individual bonds embedded in their stable value funds and calculated the ratio on the basis of purchases and sales of those securities.

Because stable value funds are using so many different formulas to calculate turnover ratios, LeLaurin said, he doesn't consider it a useful metric for the industry right now. He noted that the DOL, weighed down with more pressing matters, hasn't been able to give more detailed guidance on the issue. SVIA

Retirement Readiness: A Global Challenge

By Randy Myers

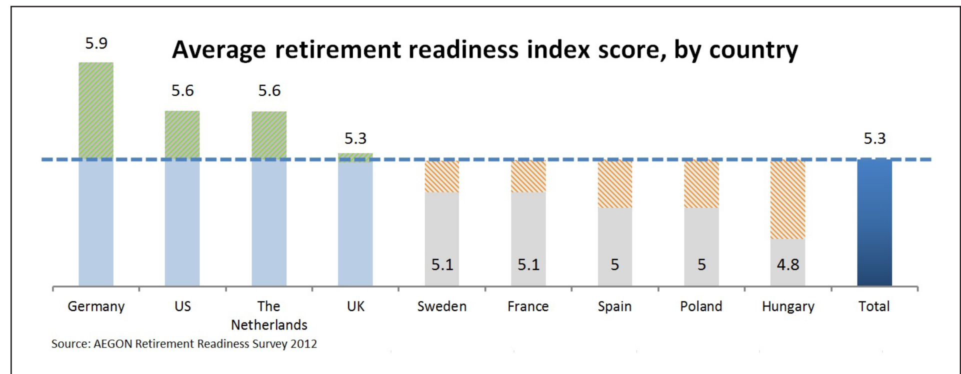
The U.S. isn't alone in facing a retirement readiness challenge. European countries are staring at many of the same problems: an aging population marked by a tidal wave of Baby Boomers in or approaching retirement, and fewer workers coming along behind them to support old-age entitlement programs like Social Security and Medicare in the US.

The citizenry in those countries are aware of the problem. According to the latest AEGON Retirement Readiness Survey, 71 percent of workers in the U.S. and Europe believe future generations of retirees will be worse off than those currently in retirement. Nearly as many—69 percent—recognize that they have a high level of responsibility to prepare for retirement, including 84 percent in the U.S. But awareness so far isn't translating into action. Only 15 percent say they are on course to meet their retirement planning goals.

The AEGON survey polled 8,100 workers and 900 retirees in the U.S., France, Germany, Hungary, The Netherlands, Poland, Spain, Sweden and the United Kingdom. While it painted a discouraging picture of the retirement outlook throughout much of the Western world, it also found that workers in the U.S. and abroad are, at least in principal, willing to consider reforms to make current old-age benefit programs more sustainable.

A surprising 88 percent of the survey respondents said they favor some form of government pension reform, Catherine Collinson, president of the non-profit Transamerica Center for Retirement Studies, told participants at the SVIA's 2012 Fall Forum. The center collaborated with AEGON in producing the study. The highest favorable response came from Hungary, where 95 percent of survey respondents backed the idea, while the lowest came from the Netherlands, where 70 percent endorsed it. In the U.S., 92 percent said they were in favor of reform.

Understanding how workers feel about reform, and what form it should take, should be useful to policymakers trying to decide not only what reforms are necessary, but which would



be palatable to voters. Just 19 percent of survey respondents favored a balanced approach that would include raising retirement ages and also increasing taxes. Another 27 percent supported raising taxes only, while 42 percent favored a reduction in the value of benefits paid out. In the U.S., Collinson said, 31 percent were in favor of raising taxes to help shore up Social Security, while 17 percent favored a reduction in benefits.

Although global life expectancies have generally been increasing, 47 percent of survey respondents contended that the retirement age in their country should not be raised. U.S. respondents were more open to the idea, with only 32 percent saying they were against it.

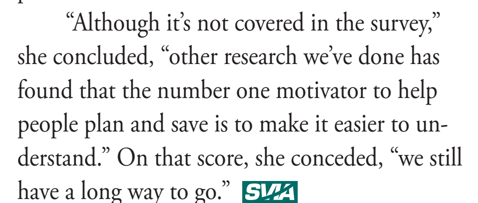
Among survey respondents already retired, 54 percent said they stopped working completely after taking formal retirement. By contrast, only 30 percent of current workers think they'll be able to afford to do that. The numbers are even more dramatic in the U.S., where 63 percent of retirees stopped working completely at retirement age but only 18 percent of current workers think they'll be able to do so.

"For many, the plan is simply to work longer and retire at an older age," Collinson observed. "That's a wonderful way to bridge the retirement savings gap, but not without a backup plan. The older we get, the more susceptible we become to life's unforeseen circumstances that could preclude the ability to work, and that could force us into retirement sooner."

Collinson noted that no country in the survey scored high in AEGON's Retirement Readiness Index, which takes into account factors such as how aware people are of their responsibility for retirement, what they're doing about it, and how much of their working income they're on track to replace in retirement. Germany scored highest, followed, in order, by the U.S., The Netherlands and the U.K. Next came Sweden, France, Spain, Portugal, and, in last place, Hungary.

AEGON's recommendations to improve retirement readiness, Collinson said, include encouraging individuals to save regularly for retirement by offering tax incentives and effective and secure workplace pension programs. Policymakers, employers and the retirement industry also should engage the public on the issue, driving home the point that without an increase in the formal retirement age, government and private pensions will become prohibitively expensive and perhaps unsustainable. Policymakers and employers also should provide options for phased retirement, she said, arguing that if all parties act now, improvements in retirement readiness are possible.

"Although it's not covered in the survey," she concluded, "other research we've done has found that the number one motivator to help people plan and save is to make it easier to understand." On that score, she conceded, "we still have a long way to go."



A Consultant's Perspective on Stable Value

By Randy Myers

A lot changed in the wake of the financial crisis of 2008, including the way retirement plan sponsors and their advisors think about stable value funds.

"Twenty years ago, clients wanted a fully benefit responsive, competitive yield from their stable value fund, with no onerous restrictions if they wanted to cancel their contract," observes plan consultant Angelo Auriemma. "Then the financial crisis hit, and their questions, and concerns, started to change."

Auriemma, director of investment advisory services for Plan Sponsor Advisors LLC, told participants at the SIVA's 2012 Annual Forum that plan sponsors still care about the yield offered by their stable value fund. In many cases, though, that has become secondary to issues such as transparency, or the ability to see what the fund's underlying investment portfolio looks like; the liquidity and composition of the investments in that portfolio; how well the fund has diversified its credit risk; the availability of wrap insurance for the fund; the covenants associated with those insurance contracts; and, in pooled stable value funds, the impact of cash flows from other plans within those funds.

Auriemma said his firm continues to recommend to its plan sponsor clients that they offer stable value as an investment option, and that most are receptive to the message. While acknowledging hearing stories about sponsors removing stable value products from their plans in favor of money market funds or other alternatives, he said that's not what his firm is seeing from most of its clients. "We're seeing some deterioration in their perception of the product, but they're not saying, 'Get me out,'" he said. "They're saying, 'Instead of spending 2.5 seconds on this at our quarterly meeting, let's spend 10 minutes.' There's just a heightened awareness of the product, and more questions."

Auriemma said his consulting firm also evaluates stable value products differently today than it did before the financial crisis. It still focuses on the attractiveness of the product relative to money market funds, but it also pays attention to the viability of new product innovations, including stable value alternatives. The firm also applies expanded and re-prioritized selection and monitoring criteria to stable value funds.

In comparison to money market funds, Auriemma said stable value funds continue to offer a meaningful yield differential that is significant to plan sponsors, especially when expressed in terms of opportunity costs. A plan with $20 million in stable value assets yielding as little as 1 percent—well below current average crediting rates—would nonetheless produce $200,000 in annual earnings for plan participants. By contrast, a money market fund yielding .01 percent—not uncommon in today's environment—would produce just $2,000 in annual earnings. "When you talk about foregone earnings on behalf of participants, sponsors' eyebrows furrow," Auriemma said.

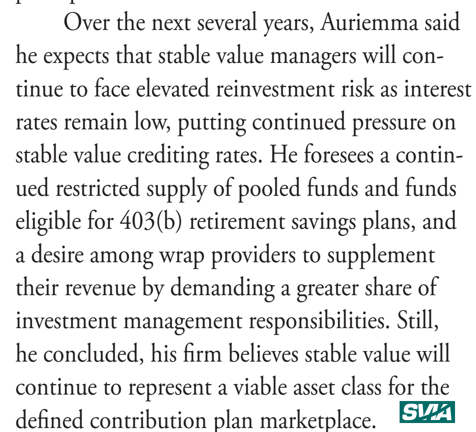
He noted that even though expenses for stable value funds have gone up since the financial crisis, mostly due to higher wrap fees, sponsors tend to evaluate the funds in terms of their net yield, which continues to be favorable relative to money market funds. He estimated that sponsors would continue to view stable value funds as attractive, relative to money market funds, even if net yields fell as low as 50 basis points.

Auriemma said his firm advises sponsors that a competitive yield should remain an important consideration, but that the duration of the underlying investment portfolio and the credit quality of that portfolio are important, too. While sponsors appear to be tolerant of some interest rate risk, he noted, they seem to have a strong preference for controlling that risk by having shorter-duration portfolios.

He said sponsors also show a preference for their stable value funds to hold publicly traded rather than non-public securities, and to stay with the traditional 12-month put option governing plan terminations in pooled funds rather than imposing a multi-year payout.

Auriemma said he's intrigued by some of the stable value alternatives the industry has been considering, including stable net-asset-value (NAV) products that are built around an insurance-wrapped portfolio of fixed-maturity, fixed-income tranches that amortize over time, and floating-rate NAV products that consist of wrapped and unwrapped portfolios of fixed-income investments. However, he said, he thinks plan sponsors will be slow to warm to them.

Over the next several years, Auriemma said he expects that stable value managers will continue to face elevated reinvestment risk as interest rates remain low, putting continued pressure on stable value crediting rates. He foresees a continued restricted supply of pooled funds and funds eligible for 403(b) retirement savings plans, and a desire among wrap providers to supplement their revenue by demanding a greater share of investment management responsibilities. Still, he concluded, his firm believes stable value will continue to represent a viable asset class for the defined contribution plan marketplace.



The Impact of Managed Accounts on Stable Value Funds

By Randy Myers

Stable value funds have long appealed to participants in defined contribution plans, and currently account for about 14 percent of the total assets held in those plans. Now, however, some participants are delegating responsibility for choosing their investments to outside advisors via so-called "managed accounts" programs. While it's not clear how that might impact allocations to stable value funds over the long term, early indications suggest that, at least with one managed account provider, it shouldn't have a significantly negative impact. And it could actually boost allocations over time.

With a managed account, the third-party advisor has discretion to decide how a participant's account will be allocated among the investment options in their retirement plan. Advice

continued on page 12

Impact of Managed Accounts

continued from page 11

provider Financial Engines offers a managed accounts program it calls Professional Management. In some retirement plans it serves, participants must opt into the service. Where that's the case, says Wei Hu, director of the company's Financial Research Group, about 13 percent to 20 percent do so. In plans where participants are automatically enrolled in the managed account option unless they opt out, about 30 percent to 45 percent stay with it.

Speaking at the SVIA's 2012 Fall Forum in October, Hu said his firm evaluates every stable value fund individually according to the characteristics of its portfolio holdings and its expected risk and return properties. It then decides how much of each participant's portfolio, if any, should be allocated to that fund. Without sharing figures, Hu said stable value funds receive a significant allocation relative to money market funds and traditional fixed-income funds. Going forward, he said, he expects that allocation to increase due to a new retirement-income feature it recently added to its service called Income+.

With the new feature, which participants will sign up to use when they're ready to retire, Financial Engines will continue to allocate participants' retirement plan assets among the existing investment options in their plans. Leveraging a liability-driven investment methodology sometimes used by defined benefit plans, Financial Engines will allocate 65 percent of a participant's assets to bond funds when the participants are 65 years of age, with the goal of generating steady payouts up to age 85. Another 15 percent will be allocated to bond funds that will be set aside to purchase lifetime income via an out-of-plan annuity option. The remaining 20 percent will go to equity funds. The allocation to bonds will gradually increase to 100 percent by the time the participant reaches age 85.

Given that managed accounts are still relatively new in defined contribution plans, Hu said Financial Engines is taking measures to keep the stable value community comfortable with them. It is keeping stable value managers and issuers informed of its plans for its Professional Management program, he said, and trying to provide visibility into cash flow events that might occur, such as a change in plan language. "That's something we work with the plan sponsor to know about well ahead of time, and, ideally, we can provide some analysis to show whether it will impact the plan's stable value holdings," Hu said.

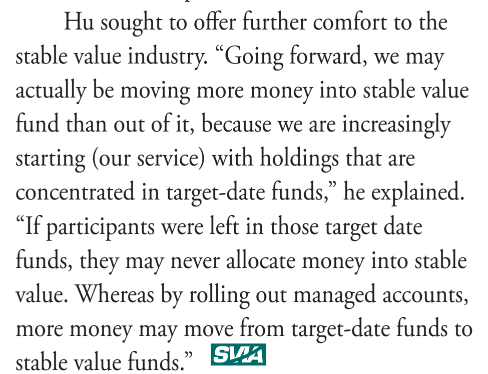
On a case-by-case basis, he said, Financial Engines also is open to implementing a net trade limit on cash flows out of stable value funds when those outflows are caused by its asset-management policies. "We hope that gives the plan sponsor community some comfort in having a discretionary manager in place," he said.

Bradie Barr, senior vice president of marketing for Transamerica Stable Value Solutions, an issuer of stable value contracts, said her firm is comfortable with decumulation products like Financial Engines' retirement-income feature. "It's much better to have money stay in (stable value funds) and trickle out over time," she noted, than to have it leave all at once.

Advice solutions and managed accounts are a bigger concern while retirement plan participants are accumulating assets, she said, especially in cases where plans provide them on an opt-out basis and participation rates can get very high. In the case of one plan her firm is working with, she noted, 60 percent of plan participants use the managed accounts option.

While that plan is an outlier—the average usage rate is closer to 3 percent to 5 percent of participants—Barr said that having 60 percent of asset allocation decisions in a plan being made by one model or advisor is an underwriting concern for her firm.

Barr said Transamerica has worked with Financial Engines to try to develop limits on outflows from stable value funds in a managed accounts environment, and also is exploring better ways to underwrite funds where managed accounts are used. About a third of the plans in her company's book of business offer managed accounts, she said, some from Financial Engines, others from other providers.



Hu sought to offer further comfort to the stable value industry. "Going forward, we may actually be moving more money into stable value fund than out of it, because we are increasingly starting (our service) with holdings that are concentrated in target-date funds," he explained. "If participants were left in those target date funds, they may never allocate money into stable value. Whereas by rolling out managed accounts, more money may move from target-date funds to stable value funds." SVIA

Stable Value and the Small-Plan Market

By Randy Myers

Stable value funds continue to play an important role in smaller defined contribution plans, and industry insiders suggest there's little reason to believe that won't continue to be the case going forward.

Wall Street bank Goldman Sachs is among the segment's champions. When it decided to acquire stable value money manager Dwight Asset Management earlier this year, says David Solomon, head of defined contribution key accounts for Goldman Sachs Asset Management, it did so after reaching three conclusions about the market for pooled stable value funds, which are the primary way that small retirement plans access stable value. First, he told participants at the SVIA's 2012 Fall Forum, it determined that there was an imbalance between supply and demand for pooled funds after some providers exited the business in the wake of the 2008 financial crisis. Second, he said, the company saw increasing demand for independent investment managers in the pooled fund space, or what the industry calls "defined contribution-investment only," or DCIO, services. Finally, he said, Goldman Sachs concluded that retirement plan participants still place a high value on stable value funds, given their capital preservation focus, their yields and their liquidity.

That sentiment was echoed by Peter Kooken, director of strategic marketing for New York Life Retirement Plan Services, who noted

continued on page 13

DOL Continues to Refine ERISA Rules and Regulations

By Randy Myers

The Department of Labor has issued many new rules governing retirement plans over the past few years, but its work is hardly done, Michael Davis, Deputy Assistant Secretary for the department's Employee Benefits Security Administration (EBSA), told participants at the 2012 SVIA Fall Forum.

Davis recited a list of his agency's recent rulemaking accomplishments, including issuing proposed regulations that would require additional disclosures about target-date funds, and developing new rules for disclosing retirement plan expenses. He also discussed four key initiatives still on the agency's plate:

After the 2012 elections, Michael Davis left the Department of Labor's Employee Benefits Security Administration to join Prudential Reitrement – a business unit of Prudential Financial, Inc. (NYSE:PRU) – as senior vice president and head of its stable value business.

Providing guidance to fiduciaries on selecting and monitoring target-date funds.

As it has sought to develop guidance on selecting and monitoring target-date funds, Davis said EBSA has had to think hard about who its primary audience will be and how sophisticated it is in terms of understanding the investment markets. "We have determined that it really is better to write to that broader audience, that smaller business audience, because these are folks who in a lot of cases don't have staff that are dedicated to these types of questions," he said. "We are toward the latter part of this project and we hope to issue something pretty soon."

Providing more guidance on how fee disclosure requirements should apply to brokerage windows within defined contribution plans.

Davis said EBSA has been concerned to hear that some plan advisors are advising clients they can avoid fee disclosure rules by having all plan investments routed through a brokerage window. That approach apparently grew out of an answer to a question EBSA had included in a list of "frequently asked questions" it published. "That was obviously a problem for us," Davis said. "We did not intend for that to happen."

"We thought we had a very strong position with respect to what we prescribed both as a legal matter and a policy matter," Davis continued. "That said, we thought people made a very persuasive argument that we needed to take a broader look at this issue, that it did not lend itself to just an FAQ, and that we should have a broader public comment process with respect to brokerage windows. We did that, and we provided an answer to what is now Question 37 which basically says if you are putting in a brokerage window to evade disclosure rules, that is highly problematic. We also said it is a fiduciary matter as far as the selection and monitoring of brokerage window providers. And we said we will have a broader conversation about brokerage windows going forward to make sure that whatever the department does is thoughtful, is considerate, and is timely with respect to the way brokerage windows are being used."

continued on page 14

Small Plan Market

continued from page 12

that in the roughly 500 smaller defined contribution plans his firm serves, approximately one in every five dollars is invested in stable value products. On average, he noted, those plans have about $75 million in assets.

"In 2008, we saw a pretty big jump (in stable value allocations) as participants made a big swing toward the stable value asset class, and that number has held pretty constant since then," Kooken told Forum participants. In 2007, he noted, participants in those plans had about 15 percent of their assets in stable value. In 2008 it jumped to 20 percent, and as of June 30, 2012, it stood at 19 percent.

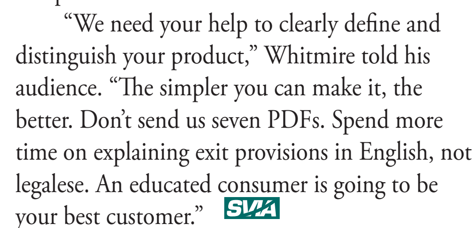
In total, Kooken said, one in every two participants in the firm's plans has some money invested in stable value. When segmented by age, Kooken said, plan participants use stable value about the way one would expect. Among Generation Y, about 30 percent of participants allocate money to the asset class. Among Generation X about 46 percent use it. Among Baby Boomers, about 60 percent do.

When segmented by industry, Kooken said, plan participants employed by technology and communications companies tend to use stable value more than those at financial and services companies, or at manufacturing or materials companies. That could be because many technology companies don't have traditional pension plans that promise stable retirement income, he theorized, or because company stock is a big holding in many of those plans and participants want to offset those holdings with a more conservative investment option.

Looking ahead, Jerry Whitmire, a financial advisor with Morgan Stanley Smith Barney 401(k) Specialists, said the stable value industry could help its cause in the small-plan market by more clearly defining its product, both for plan sponsors who may not be intimately familiar with how it works and for plan sponsor consultants, too.

One of the biggest challenges those two groups face right now, he said, is trying to evaluate the risks associated with stable value portfolios and stable value managers. He said it's also hard to compare one stable value fund against another due to differences in the way providers disclose information about them. And, he said, sponsors and consultants alike often find it difficult to understand how stable value contract exit provisions work.

"We need your help to clearly define and distinguish your product," Whitmire told his audience. "The simpler you can make it, the better. Don't send us seven PDFs. Spend more time on explaining exit provisions in English, not legalese. An educated consumer is going to be your best customer."



The Fiscal Cliff: Where Politics and Economics Meet

By Randy Myers

Maybe we haven't seen anything yet.

Sure, Washington has been filled with partisan bickering for the past few years, but as the republic prepares to sail over a fiscal cliff it seems likely that the debate and rhetoric in our nation's capital will be characterized by a heightened sense of urgency and increased vitriol.

"There's always a chance that we will have, instead of a ridiculous series of fights and idiotic debates, a good outcome," Washington Post and Bloomberg columnist Ezra Klein told participants at the 2012 SVIA Fall Forum. "It's a small chance—it's connected to that Mayan asteroid thing—but it's a chance."

In a wide-ranging analysis of the economic problems confronting Washington and the political considerations that play into its decisions, Klein said many who see a realistic chance of a good outcome like to point to the Simpson-Bowles deficit-reduction plan as a possible route to reform. But, he contended, very few people seem to know what's in it. If they did, he said, they might not be so optimistic about its chances of gaining widespread support in Congress.

The plan, he said, includes $2 trillion in tax increases, more than President Obama has proposed. It also includes about twice the level of defense cuts Obama has proposed. It includes Social Security cuts that neither party has proposed, healthcare savings that rely on a stringent cap in healthcare spending, and a tax-reform plan that gives Congress responsibility for nailing down specifics.

Still, Klein said, it will be important for Washington to act at some point. The impending fiscal cliff refers to a combination of automatic spending cuts and tax hikes scheduled to take effect beginning on January 1, 2013. The good news? It would pretty much resolve the nation's budget deficit problems. The bad news? It would, by most economists' projections, quickly send the country into a devastating recession. It also wouldn't be a smart way to do policy, Klein warned, since its spending cuts would be imposed indiscriminately across many programs. "It's an incredibly blunt instrument," he said.

What the fiscal cliff might not be, though, is an actual cliff, but rather more of a slope, since much of the savings come in over a period of 10 years. Depending upon who the next president is, Klein said in his early October address to the SVIA, Congress could take quite a while before coming up with a solution—perhaps waiting until sometime in 2013, or even 2014.

Still, he said, both political parties have strong incentives to avoid the cliff. The cliff policies would allow the Bush tax cuts to expire, for example, when almost everyone agrees that comprehensive tax reform would be a better idea. And, Klein argued, the tax increases it imposes are on a scale that no Democrat would be prepared to propose, while Republicans have an even stronger aversion to tax increases. The latter point alone, he said, should drive Republicans to the bargaining table.

Yet nothing looks to come easy on this front. The fiscal cliff issue is further complicated, Klein noted, by the fact that the federal government is on track to bump up against its debt ceiling early in 2013. The last time that happened it became a partisan issue, with Congress failing to pass a debt-ceiling increase until the last possible moment. SVIA

DOL Continues to Refine ERISA Rules and Regulations

continued from page 13

Issuing new regulations that further define who qualifies as a fiduciary to a retirement plan.

The push to redefine who qualifies as a fiduciary to a retirement plan, Davis said, stems largely from a shift in the types of plans most employers now offer. When the Employee Retirement Income Security Act was passed in 1974, most plans were defined benefit plans. Today, defined contribution plans are more common, and account for more retirement assets. Accordingly, knowing who's providing advice to those plans, and what their qualifications and responsibilities are, is increasingly important.

"We knew it was going to be a robust debate with a lot of comments and passions on both sides," Davis said. "Do we need stronger fiduciary protections, yes or no? If so, how should they be delivered? What's the regulatory model for delivering it? How should we work with our colleagues at the SEC and others to make sure we deliver a seamless system? All those questions are questions that occupy us on this project every day."

Davis said EBSA is working closely with the SEC to make sure it doesn't create a suite of rules that aren't harmonious with rules from other regulators.

Helping retirement plan sponsors and plan participants do a better job of converting retirement savings into lifetime income.

The challenge of converting retirement savings to retirement income is becoming increasingly important, Davis said, as the 76 million Baby Boomers born between 1946 and 1964 begin leaving the workforce. "We have had a hearing with Treasury on this, and we are now in the formative stage of steps we are going to take," Davis said.

One of the possibilities regulators are considering, Davis said, is requiring plan sponsors to issue retirement plan statements that show not only actual balances in 401(k) accounts, but also what those balances would equal if they were paid out in monthly installments, such as those that could be taken from an annuity. But it's not a simple issue, he noted. Some retirement experts wonder if doing this would encourage or discourage retirement savings. And assumptions would have to be made in calculating what the monthly benefits would be. "Even the use of the word 'annuity' is a debate," Davis observed. "Some say you shouldn't pay it out in an annuity format but as a drawdown from an asset allocation product. We are working to resolve these debates. To use a baseball analogy, we are in the eighth inning of a nine-inning game in getting the pension benefit statement rules out, and we hope to get them out soon." SVIA

Apples to Apples Disclosure: Stable Value and the New Participant Disclosure Rules

By Jean Marie Petty, Galliard Capital Management

Participant fee disclosure rules published by the Department of Labor (DOL) went into effect in 2012, presenting new reporting challenges for the defined contribution industry, including stable value. The key purpose of the new disclosure is to achieve greater transparency and more meaningful comparisons of investment options in participant-directed retirement plans. This article highlights some of the key investment-related disclosures required by the Employee Retirement Income Security Act (ERISA) Rule 404a-5 and particularly how these disclosures have impacted stable value investment options.

Key Impact of the Participant Disclosure Regulations on Stable Value

Many of the new investment-related disclosures in ERISA Rule 404a-5 were modeled or based on existing Securities and Exchange Commission (SEC) disclosure requirements for registered mutual funds. Stable value investment options which are non-registered investments and typically packaged as either collective trust funds or customized individually managed accounts, needed to adopt and/or modify certain investment-related disclosures in order to comply with the new participant disclosure regulations.

The following are some of the key changes made to stable value disclosure as a result of the new disclosure regulations.

Total Annual Fund Operating Expenses

Given the customized nature of stable value investment products, the stable value industry as a whole did not have a commonly accepted practice for reporting a stable value fund's total operating expenses. Thus, the DOL's recent requirement to provide a more consistent calculation of total operating expenses for non-registered investment alternatives was a significant reporting change for the industry. In the DOL's final ruling, it was determined that certain expenses (e.g. investment contract fees) must now be included in the total annual operating expenses of the fund. For many stable value funds, the new reporting methodology, particularly the inclusion of stable value investment contract fees, caused an increase in expense ratios. It is important to note, however, that while many expense ratios for stable value funds increased as a result of the new disclosures it has always been common practice for these fees to be reported and to be included in after-fee portfolio returns.

See "New Reporting Requirements Provide Insights Into Stable Value Fees," for more information.

Turnover Ratio

Annual portfolio turnover is required for most investment options and must be reported in a manner consistent with the SEC's form N1-A or N-3, as appropriate. Money market funds and other investment products with similar investment objectives, however, are not required to provide a portfolio turnover rate. Stable value portfolios have unique issues regarding turnover given the contract value and market value components of a typical stable value fund. Given the various nuances and unique attributes of the stable value asset class, the industry has not reached a consensus on turnover and turnover methodology may still vary.

Broad-Based Securities Market Index

ERISA Rule 404a-5 requires the use of a published broad-based securities market index. In a recent survey by the Stable Value Investment Association, the most commonly used benchmark is the 3-Month U.S. Treasury Index. Given the market value and contract components of a stable value fund however, it is typical for many stable value managers to provide multiple benchmarks depending on a client's benchmarking needs.

Information Comparable to Short Form Summary Prospectuses

Unlike registered mutual funds, stable value funds are not required to have prospectuses. While the new regulations do not require prospectuses per say, plan administrators are now required to provide participants either automatically at predetermined intervals or upon request, with documents for all investment alternatives that are similar to short-form or summary prospectuses. As noted in the DOL's Field Assistance Bulletin (FAB) No. 2012-02R, "Whether a document is similar to a prospectus, or a short-form or a summary prospectus, would depend on the particular facts and circumstances…Alternatively,

continued on page 16

Highlights from AARP's "Boomers and the Great Recession: Struggling to Recover"

By Gina Mitchell, SVIA

A recent AARP report focuses on the major challenges that baby boomers, those aged 50 and older, face from the Great Recession. As the title portends "Boomers and the Great Recession: Struggling to Recover," the report documents how boomers were affected and coped with the challenges of the market meltdown in 2007 and the subsequent Great Recession, which they say ended in October of 2010. The report pointedly notes that "the young have time on their side and the old are to some degree protected by Social Security and Medicare." So what cushions the boomers?

The short answer predictably is uninterrupted full-time employment; having current, desirable skills and/or more education; being part of a household or a couple; having savings; and being female. As many have documented, men have had a tougher time at least in terms of unemployment and reemployment during this economic cycle than women.

However, even when blessed with these "cushions," boomers were impacted by declining home values, investment losses as well as declines in savings or exhausted savings. In fact, the report found that, "boomers are uncertain and probably frightened about what the future holds

continued on page 20

Apples to Apples

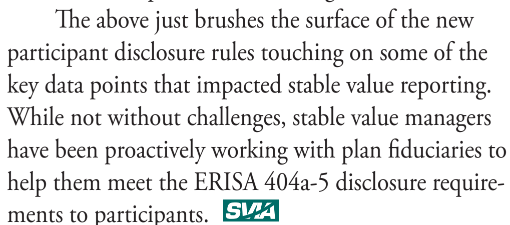
continued from page 15

similar to short-form or summary prospectuses, bank fund fact sheets ordinarily may be used to satisfy this disclosure requirement, because they would contain information that corresponds to that contained in short-form or summary prospectuses." As a result of the new disclosure rules, many stable value providers have revisited the information contained in fact sheets and other informational materials produced to evaluate whether or not the literature satisfies the new disclosure requirements.

An Exception for Expense Ratios

Some stable value funds are subject to different disclosure rules. These stable value funds are considered variable return products or annuities by the DOL. A notable difference for these types of investment products is that the operating expense ratio is waived for funds having a fixed rate of return. Because some stable value funds that are made available through a general account structure provide a fixed rate of return for a stated period and transfer investment risks to the insurer, it normally would not be necessary to provide annual operating expense information for such products. Although DOL did not fully explain its rationale for excluding variable return and annuity products from the expense ratio requirement, many assume that DOL believes operating expense information is not helpful to plan participants since the investment risk is transferred to the insurer and participants' rate of return is not dependent on the expenses associated with any segregated pool of assets. DOL clarified in the final regulations that while stable value and money market mutual funds aim to preserve principal, they are not free of investment risk and accordingly are subject to variable return provisions of the regulations.[1]

The above just brushes the surface of the new participant disclosure rules touching on some of the key data points that impacted stable value reporting. While not without challenges, stable value managers have been proactively working with plan fiduciaries to help them meet the ERISA 404a-5 disclosure requirements to participants. SVA



Key Investment Disclosures Required for Stable Value and Other Variable Return Investment Products[2]

In addition to requiring the name of each investment alternative and a glossary of terms be provided to participants and beneficiaries, the other core categories of investment-related information required by the new regulation include:

Performance Data

- Average annual total return over 1, 5 and 10-year periods, measured as of the end of the applicable calendar year
- A statement that an investment's past performance is not necessarily an indication of how the investment will perform in the future

Benchmark Information

- The benchmark name and returns of an appropriate broad-based securities market index over the same 1, 5 and 10-year periods as the performance data disclosed
- The benchmark is not permitted to be administered by an affiliate of the investment issuer, its investment adviser, or a principal underwriter, unless the index is widely recognized and used
- Additional benchmark information is permissible so long as the index is widely recognized and used

Fee and Expense Information

- Total annual operating expenses of the investment expressed as a percentage are required to be calculated
- Total operating expenses for a one-year period expressed as a dollar amount for a $1000 investment (assuming no returns and based on the total annual operating expense percentage disclosed)
- A description of any restriction or limitation that applies to a purchase, transfer or withdrawal
- Three fee-related statements must be included:
    - Fees and expenses are only one of several factors that participants and beneficiaries should consider when making investment decisions
    - The cumulative effect of fees and expenses can substantially reduce the growth of a participant's or beneficiary's retirement account
    - Participants and beneficiaries can visit the Internet website of the Employee Benefits Security Administration for information and an example demonstrating the long-term effect of fees and expenses

Internet Website

The DOL requires that a website be maintained to provide participants and beneficiaries with uniform and specific investment-related information, and access to specific and uniform information about their investment options. Calculations and descriptions are required to be done in a manner that is consistent with Form N-1A or N-3. The data required on the website includes the name of the investment's issuer or provider, the investment's objectives or goals, the investment's principal strategies and risks, portfolio turnover, investment performance and related fees and expenses.

[1]See Department of Labor 29CFR Part 2550, Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans, page 29.

[2]Ibid.

Portrait of a Plan Participant

By Zach Gieske, SVIA

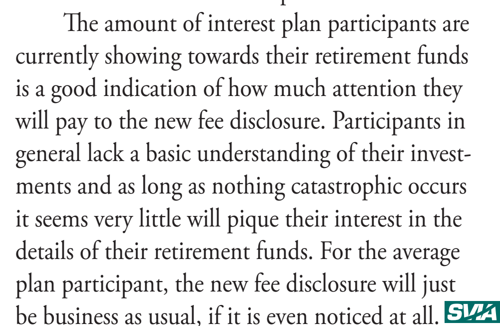
In the wake of recent regulations, plan participants are soon to be provided with more information than ever regarding their defined contribution plans. In the lead up to fee compliance, issues such as getting the information out to participants and ensuring that they know how to access it have been considered. However, the matter of what plan participants will do with the fee disclosure information has been overlooked.

> *"401(k) assets had fallen historically and have now finally actually recovered their losses during the Great Recession. So that we can say now that we have the highest nominal value of 401(k) assets on record."*
>
> Gene Sperling, Director of the National Economic Council and Assistant to the President for Economic Policy

To gauge how participants may react to fee disclosures, a good place to start is with a recent survey conducted by the AARP entitled "401(k) Participants' Awareness and Understanding of Fees," which found that 70% of those surveyed did not believe they paid any fees as part of their plans. The approach of a recent Department of Labor webcast, "Retirement Savings: Saving More for Tomorrow by Paying Less in 401(k)," served to reinforced the idea that participants aren't well informed about their plans. The DOL presentation focused on the basics necessary to understand the new information being disclosed to participants instead of demonstrating how to make more informed decisions with this information. The webcast used rudimentary examples, such as comparing a $25,000 investment with 7% return over 35 years using a 0.5% fee and a 1.5% fee. It demonstrated how increasing the fee by just 1% will lead to a 28% difference in account balance, a shocking example to some but elementary investment math to others. The webcast also described why it is necessary to look not just at current rate of return for an investment, but at rates during the past one, five, and ten years, and that an investor looking at a product with a fixed rate of return should also pay attention to the annual rate and the term of the investment. In other words, it focused exclusively on the very basics of investing. The new regulations also seem to cater to an uninformed audience by requesting that operating expenses be expressed both in percentages as well as dollar amounts per $1,000, and that a glossary of financial terms be provided to participants.

How well do plan participants understand their investments? A closer look at the AARP survey paints a dismal picture of plan participants' understanding of fees. While 70% of those surveyed didn't realize they were charged fees, of those who did understand that retirement plans include fees, 62% didn't know the amount of fees they were being charged. Even with the lack of information, 81% of those polled said they believe fees are very important in decisions regarding their plans and 64% responded saying they prefer to make their own investment decisions. In addition, 51% said they would change their investments to reduce fees if needed. Not surprisingly the younger investors, those under 50, typically knew less about their 401(k) plans. Younger investors who professed to not knowing they were charged fees averaged 10% higher than older investors, and of investors who understood that investment managers charge fees, 10% more investors under 50 admitted they had no idea how much they were paying. Those who did say they knew how much they paid in fees responded with amounts as high as 75%. Interestingly, the majority of older investors said they would not bother speaking with their employer to try to lower their fees, but the majority of younger investors said they would.

To better understand plan participants, SVIA polled a random sampling of 401(k) investors about their plans. They were asked if they knew how much they paid in fees for their accounts, if they knew what their rate of return was, and if they would try to change their investments if either the fees or the rates weren't what they expected. The results were very consistent with the AARP survey, and when asked about fees two participants said "no idea, I have paperwork at home," and "there are no fees with [my] retirement plan." The most informed response received was regarding rates of return, with one participant telling SVIA that they did not know their current rate but that "[they] usually check about once a quarter to make sure it's above 3%." However, another respondent told SVIA that their account "has no interest, you put as much as you want aside towards it and it is taken out before taxes and has no interest but the company matches dollar for dollar up to 6% of your pay for the year." Responses to the question on taking active control of 401(k) accounts reflected participant's lack of engagement with their investments. Answers ranged from "depends if it would be worth it, if it was drastic I'd look into it, otherwise probably not bother," to "I try to have as little to do with it as possible."



The amount of interest plan participants are currently showing towards their retirement funds is a good indication of how much attention they will pay to the new fee disclosure. Participants in general lack a basic understanding of their investments and as long as nothing catastrophic occurs it seems very little will pique their interest in the details of their retirement funds. For the average plan participant, the new fee disclosure will just be business as usual, if it is even noticed at all.

SVIA Meeting Dates 2013-2014

Spring Seminar 2013
April 14-16, Palm Beach, FL

Fall Forum 2013
October 14-16, Washington, DC

Spring Seminar 2014
April 27-29, Scottsdale, AZ

Fall Forum 2014
October 13-15, Washington, DC

Moody's Fires a Shot Across the Bow of U.S. Treasuries by Considering Downgrade – Implications for Stable Value Funds

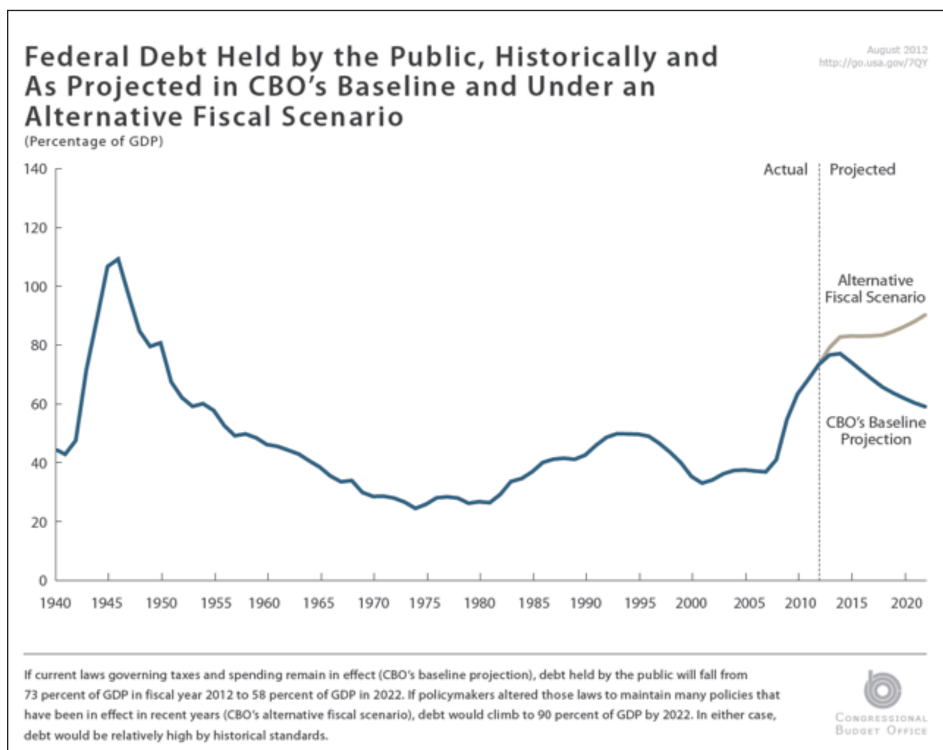
By Marijn Smit, Transamerica Stable Value Solutions

On September 11, 2012 Moody's provided an update on the outlook for the US Government's credit rating. In this update, Moody's stated that budget negotiations in 2013 will likely determine the direction of the US government's current Aaa rating, with negative outlook. The scale of any potential downgrade seems to be limited, as Moody's indicated it would probably expect to lower the rating to Aa1. This would put Moody's rating on par with the equivalent S&P rating, following that agency's downgrade of the US Government's credit rating in August of last year.

The only way to avoid this move by Moody's seems to be if the specific policies that result from the budget negotiations produce a stabilization and then downward trend in the ratio of federal debt to GDP over the medium term. If this best case scenario plays out, the rating will likely be affirmed and the outlook returned to stable.

While maintaining the current Aaa rating with a negative outlook is also an option, this is not a long term position that Moody's seems comfortable taking. If the much discussed "fiscal cliff" would actually materialize and become the method used for debt stabilization, Moody's could defer judgment and maintain its current rating stance into 2014 as it analyzes how the economy recovers from this fiscal shock.

To see two potential paths that the ratio of federal debt to GDP might take, it's helpful to consider the last CBO projection from August of this year (see chart). While under the CBO's Baseline projection the federal debt to GDP ratio declines to 58% of GDP in 2022 from 73% in 2012, this is clearly not the baseline that Moody's is basing its concerns on. In fact, the term baseline seems somewhat misleading. In many other contexts this is usually seen as equivalent to the central, or most likely, case. In the CBO context, the baseline is simply a projection based on the assumption that current laws governing taxes and spending remain in effect. This essentially means that the baseline scenario assumes that the fiscal cliff will occur and the effects of the fiscal cliff will stay in place.



However, the CBO clearly recognizes that political forces are at play and that attempts will be made to maintain certain policies that have been in effect in the current year. The CBO therefore also presents an alternative scenario. Under this alternative scenario, the fiscal cliff is avoided and the CBO makes certain assumptions, including that the expiring tax provisions will be extended indefinitely and that the automatic spending reductions required by the Budget Control Act do not occur, among others.

While avoiding the fiscal cliff, the alternative scenario sees federal debt to GDP rise to 90% by 2022 – a trajectory that clearly is the kind that has Moody's concerned. In both the baseline and the alternative scenario, the CBO points out that debt levels would be high by historical standards. In short, there is plenty for Moody's to worry about and with political uncertainty coming into play, it is not surprising that Moody's is hedging its bets and providing the proverbial "shot across the bow" with its update.

Implications for stable value

The implications of a potential downgrade in the US credit rating for stable value can broadly be put into two categories: impact on the performance of the underlying portfolios and impact on investment guidelines governing stable value funds and contracts.

Given the high allocation of government securities in stable value portfolios, deterioration in the credit fundamentals of these securities is something that should be watched closely by those in the industry.

continued on page 19

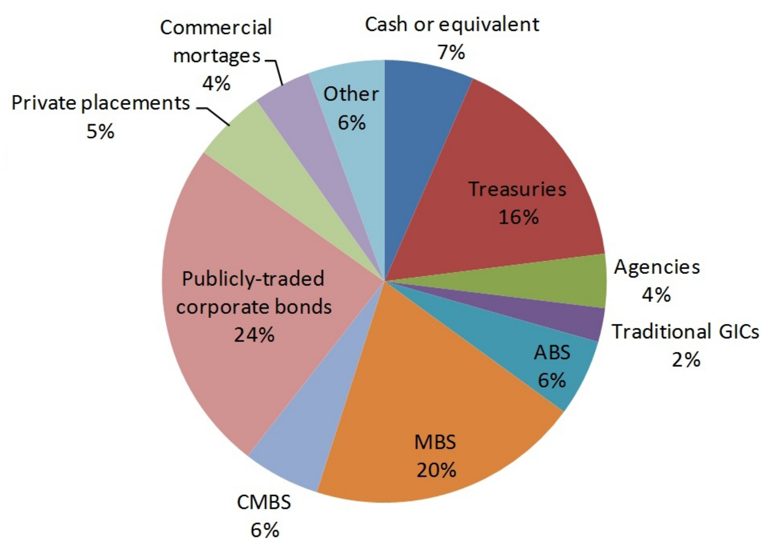
Shot Across the Bow

continued from page 18

Based on the 16th Annual SVIA Stable Value Investment & Policy Survey, Treasuries and Agencies made up over 20% of the underlying fund asset allocation in stable value. In addition, most mortgage-backed securities are backed by agency mortgages and account for another 20% of stable value's underlying fund asset allocation.

Given the very low yield environment and the strong performance of Treasury securities over the past few years, clearly the market currently still believes that US Government debt is a good investment. Treasuries actually performed well following the S&P downgrade last year and as such, the implications of a move by credit rating agencies should not be exaggerated. Still, to the extent that a future downgrade by Moody's would signal a change in market sentiment around the soundness of investing in US debt, this could affect the performance of the portfolios underlying stable value. Given the very low yields on government securities and their strong performance so far, it is clear that further strong upside potential is limited (unless rates turn negative) whereas the room for yields to increase and US debt to start performing more poorly at some point seems much larger. This is not to say that there is no longer term value of investing in US debt and contracts typically require a minimum allocation to US debt. The point is simply that generally all stable value portfolios will have some level of allocation to US debt and this means that these portfolios are sensitive to performance of this asset class to varying degrees.

With current market values in stable value portfolios generally being substantially above book value, there is plenty of cushion in most portfolios to withstand some return drag, which would be difficult to avoid entirely Also, crediting rates should remain largely unaffected in the short run from a change in interest rates alone. Many managers have been running their portfolios at fairly short durations and with elevated cash buffers, making portfolios better equipped to withstand rising rates if they do materialize.



Of course, the exact effects will depend on the magnitude of any change in the performance of US debt and related securities. The bigger issue is how the US debt situation will ultimately play out, possible cross-over effects to other asset classes and the impact on the overall economy. A prolonged period of strongly rising rates and/or increasing credit spreads would be most challenging. However, this is unlikely to be triggered by the action of a single rating agency that has already conveyed its intentions.

The more immediate impact of a change in crediting rating by Moody's would be on how investment guidelines contemplate handling the situation. While there are several sets of guidelines that could govern a stable value portfolio, for the purposes of this article we will focus on investment guidelines in wrap agreements.

Wrap Agreement Guidelines:

Wrap agreements tend to have detailed requirements around minimum average credit quality and the credit quality for individual holdings and asset classes. Wrap agreements generally require the average credit quality of portfolios to be solidly investment grade, with many agreements requiring a minimum AA average quality. Based on SVIA's Stable Value Funds' Quarterly Characteristics Survey, the average credit quality of wrapped stable value assets was slightly above AA at the end of June 2012.

How investment guidelines capture credit ratings can differ, especially with respect to ratings from multiple agencies. Most wrap agreements require at least two ratings, with some requiring three. When ratings differ among ratings agencies, most agreements take the middle rating when there are three ratings and the lower of two when there are two. When S&P downgraded US debt last year, the impact on guidelines was limited since under most guidelines US debt was still considered AAA when following the "middle of three" rule.

If Moody's were to change their rating to Aa1, as they indicated they might, under many wrap guidelines the assigned rating would drop as well. Depending on the structure of individual portfolios and the required average credit quality, there could be instances where portfolios are pushed out of compliance. In addition, guidelines might prevent any further purchases of government debt as there are minimum "at purchase" requirements. If these state that

continued on page 20

Shot Across the Bow

continued from page 19

government and related debt has to be purchased at AAA, it effectively shuts off a large part of the market for reinvestment.

Wrap providers and managers will have to work through Moody's downgrade if it occurs, as they did with the S&P downgrade in August 2011. This situation, however, presents more complications as it now involves two of the three major debt rating agencies. They should plan for the possibility ahead of time, so they know how the issue could be addressed. There are several mechanics to address the issue from a guideline perspective; the acceptability of each will depend on the exact circumstance and risk tolerance of the parties involved. Some of the options are highlighted below.

Typically, investment guidelines require a minimum allocation to US government securities. The question for issuers is whether this represents a credit-quality preference, or a sector preference. If it is the latter, than the following three approaches are options:

Deem US government debt to be rated AAA for guideline purposes, irrespective of the ratings that rating agencies assign to it. The benefit of this approach is that it is relatively straight forward, does not need to be updated for rating agency changes, is fairly easy to implement and can address both the average credit quality and at-purchase issues at the same time. The downside is that it does not contemplate very severe scenarios where deeming the debt AAA is no longer appropriate and exposes a wrap provider to a risk it did not agree to take on.

Another approach would be to apply the highest rating of three rating agencies. This again would be fairly simple to implement as a guideline change, but obviously only works if Fitch retains its AAA rating on the US, which is also not certain. While this could be a quick stop-gap measure, it's unlikely to be a good solution.

A third approach would be to make no guideline changes and let current guidelines govern what needs to occur. This would be easiest from a contractual standpoint as it requires no new agreement to be reached. It could have major consequences for the portfolios, and introduce many complexities. If a portfolio is out of compliance on an average credit quality basis driven by the downgrade, the manager would become a forced seller of lower rated assets while having to find AA or better rated assets to reinvest in. At the same time, if the at-purchase requirement for government debt is AAA, the proceeds from the sold assets could not be used to buy government debt and the manager might be challenged to find enough highly rated securities in other sectors without breaching sector limits. The portfolio would thus probably end up with a large over allocation to cash. Given these

continued on page 21

AARP Highlights

continued from page 15

for them as they edge toward retirement." Here's why:

- 17 percent of the boomers when first surveyed in 2010 were jobless and looking for work.
- 12 percent although reemployed reported that they had been unemployed.
- 40 percent reported experiencing some decline in income.
- 51 percent said they were less secure financially than they had been before the crisis and had experienced difficulty making ends meet.
- 67 percent of boomers had experienced some reduction in retirement savings balances.

As the chart illustrates, the major reasons boomers reported that they had difficulty making ends meet during the recession were an increase in every day expenses, a decline in household income, and extraordinary and unexpected expenses.

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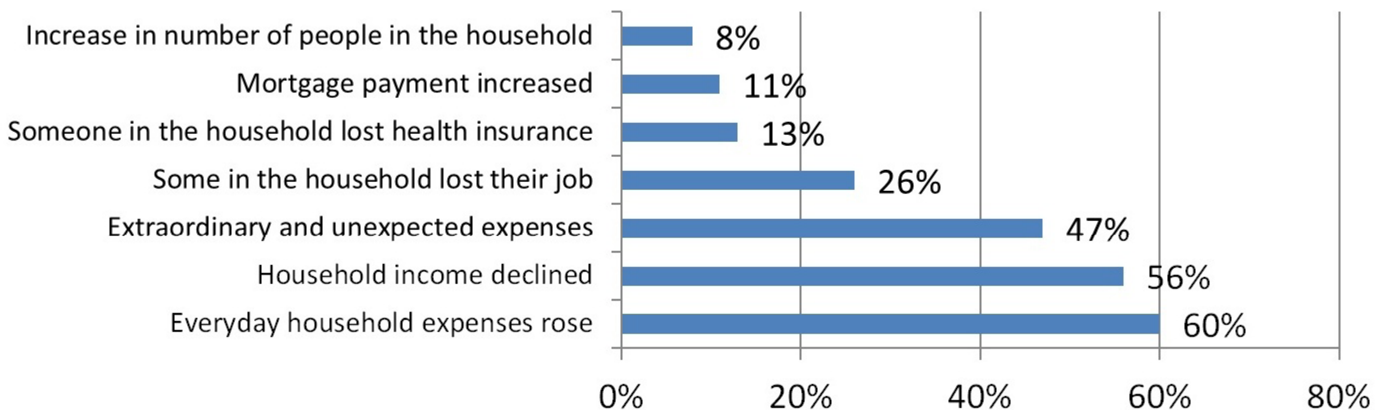


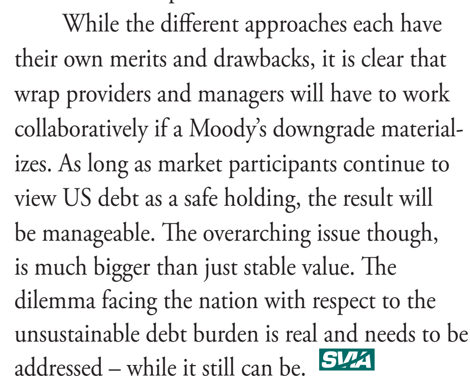
Shot Across the Bow

continued from page 20

complexities, this course of action probably only makes sense if one of the parties to the contract believes that given the circumstances it is best to wind down the contract and terminate.

Where the issuer's primary objective is the average credit quality of the portfolio, the minimum US Treasury allocation needs to be re-evaluated to avoid the consequences outlined above.

Therefore, a fourth and perhaps most balanced approach would be for a wrap provider to lower its average credit quality requirement by one notch if portfolios were pushed out of compliance. In addition, the methodology for ascribing a rating to holdings could be unchanged, but the requirement for government debt could be lowered from AAA to AA- or the equivalent. Finally, new purchases at the lower rating would be allowed. The benefit of this approach would be that it addresses the immediate concerns, while retaining a governing mechanism in case of further downgrades. This way, appropriate reassessments can be made if circumstances change



and parties are not locked into a treatment that does not contemplate more severe future moves.

While the different approaches each have their own merits and drawbacks, it is clear that wrap providers and managers will have to work collaboratively if a Moody's downgrade materializes. As long as market participants continue to view US debt as a safe holding, the result will be manageable. The overarching issue though, is much bigger than just stable value. The dilemma facing the nation with respect to the unsustainable debt burden is real and needs to be addressed – while it still can be. SVA

AARP Highlights

continued from page 20

Interestingly, boomers did not give loss or reduction of savings as a reason they had difficulty making ends meet. Some 67 percent of boomers reported some reduction in retirement savings balances during the recession. The 67 percent who reported a reduction in savings balances were also nearly the same regardless of employment status or gender. However, boomers seemed to have weathered this setback surprisingly well since 60 percent also reported that they were somewhat positive about the future of their retirement savings. Further, 10 percent reported that their retirement savings balances had been restored to pre-crisis levels and almost half reported that balances were moving in a positive direction.

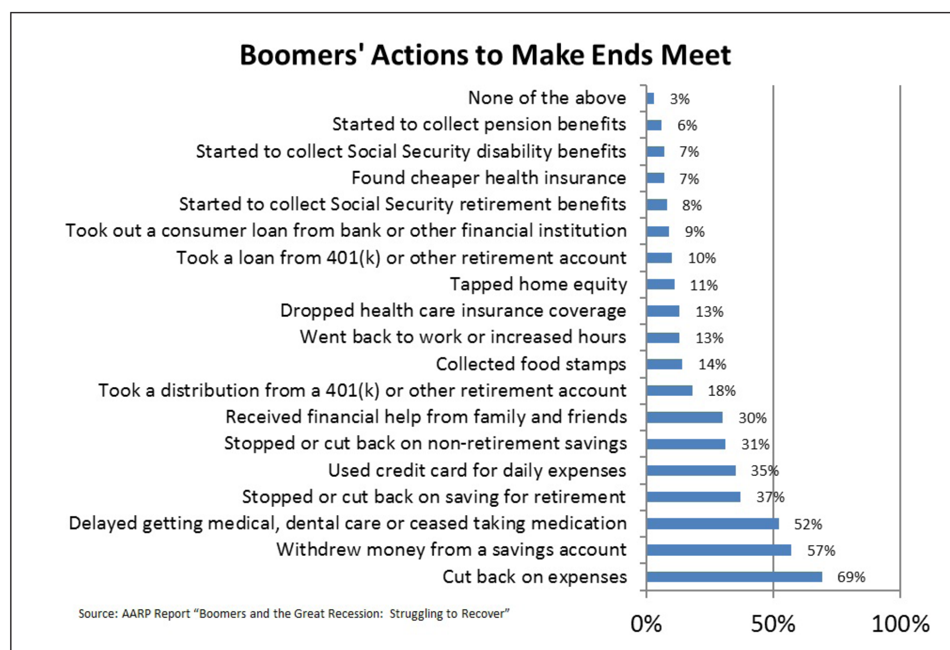
The report found that boomers did make efforts to live within their means. In fact, the majority cut back on expenses, withdrew money from a savings account or delayed medical care and/or filling prescriptions. Some 37 percent stopped or cut back on savings for retirement, while 31 percent stopped or reduced non-retirement savings. The chart details the different strategies boomers deployed to live within their means.

The report also focused on how the crisis affected boomers' attitudes towards debt and savings. The report found 45 percent of boomers were either somewhat or very uncomfortable with their level of debt. For the 15 percent who were jobless that participated in the surveys, the percentage rose to 66 percent that were uncomfortable with their level of debt.

The report found that whether or not boomers were saving for retirement was highly dependent on their employment status. Half stated they were saving for retirement. The percentage rises to 67 percent for those who were continuously employed but drops to 41 percent for those who have experienced unemployment and declines even further to 17 percent for those who are currently unemployed. While these numbers might seem encouraging given the recession, when boomers were asked about the size of their retirement nest eggs, 51 percent reported balances under $100,000, which is woefully insufficient for most given their proximity to retirement.

For the other half of boomers who reported they were not saving for retirement, 75 percent said they had saved for retirement in the past, but they also reported having saved less than $100,000 in total. While none of the savings statistics were very encouraging, the report found that boomers were aware of the shortcomings of their saving habits and had taken steps to move themselves towards a more financially secure

continued on page 22



AARP HIghlights

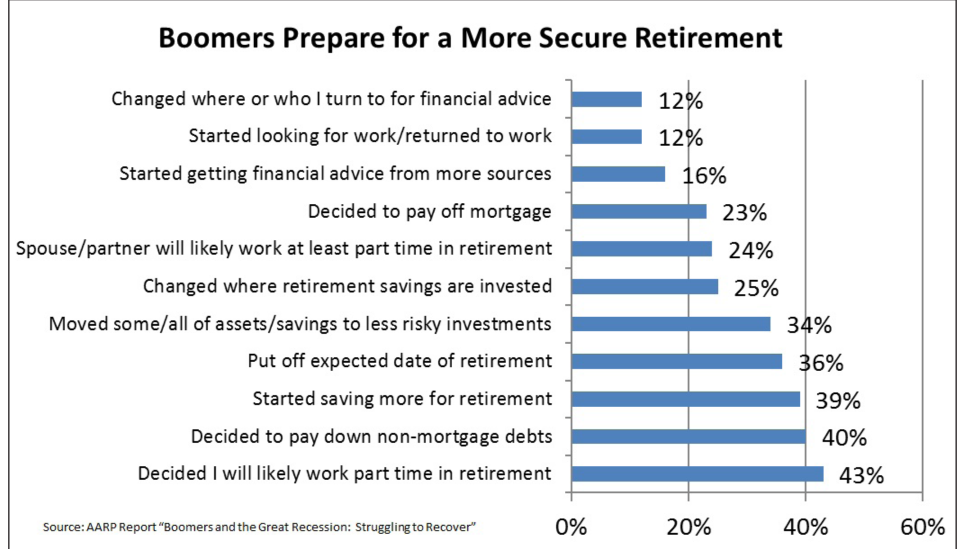
continued from page 21

retirement. The chart details the steps boomers had reported taking.

When AARP did the second survey to determine how boomers felt having ridden out the recession (the report defines the recession as beginning in December 2007 and ending in October of 2010), they found mostly a somber group. Some 24 percent reported their financial position had declined in the year between the two surveys due to declines in their savings and going deeper in debt. Another 22 percent said their sour outlook was due to their inability to find a job.

The second survey also found nine percent who described their financial status as having improved. The top reasons for this improvement were reducing or getting out of debt (36 percent), increasing income through a promotion, raise or better-paying job (33 percent) and rebuilding retirement savings (29 percent). The two charts included detail the reasons given for boomers saying their financial situation had improved or declined.

Boomers reported nagging concerns over the economy and their financial situation. For example 70 percent said they were somewhat or very worried about another recession, high inflation, rising taxes and further decline of the stock market. Interestingly, the survey did not ask, nor did boomers report concerns about low interest rates, which has reduced the effect of compounding, which Albert Einstein once hailed as the Eighth Wonder of the World, to a non-event.



The report also offers a series of policy options to address many of the employment issues and retirement concerns that plagued boomers in the recession. Two of the options address retirement, while the others are more employment or anti-age discrimination focused. The retirement policy options are:

Encouraging workers to save, to save more, and to keep retirement savings invested for retirement. The report found that when unemployment occurs, retirement savings were understandably used as income. As part of this recommendation, the report suggests improving the adequacy of unemployment benefits as well as providing job training and job search assistance to lessen the need to tap retirement savings by reducing periods of extended unemployment.

Recognizing Social Security as the bedrock of retirement income security and that the majority of workers will remain dependent upon this program for income support. As the crisis proved, defined contribution plans and personal savings are highly vulnerable to the downside of the market especially for those close to or in retirement.

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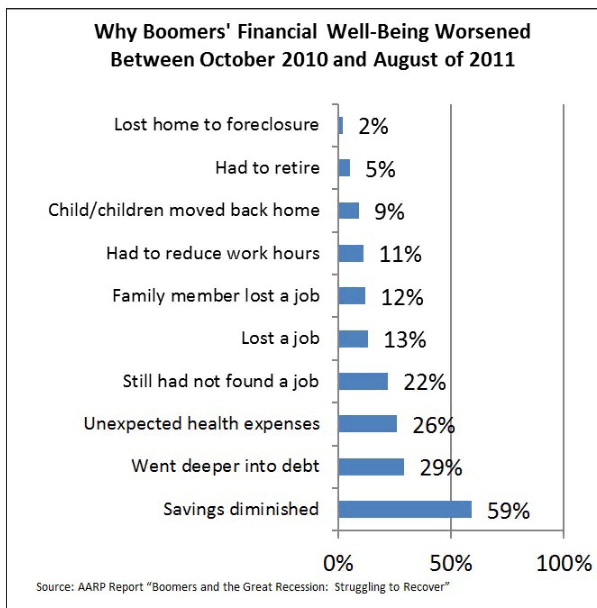
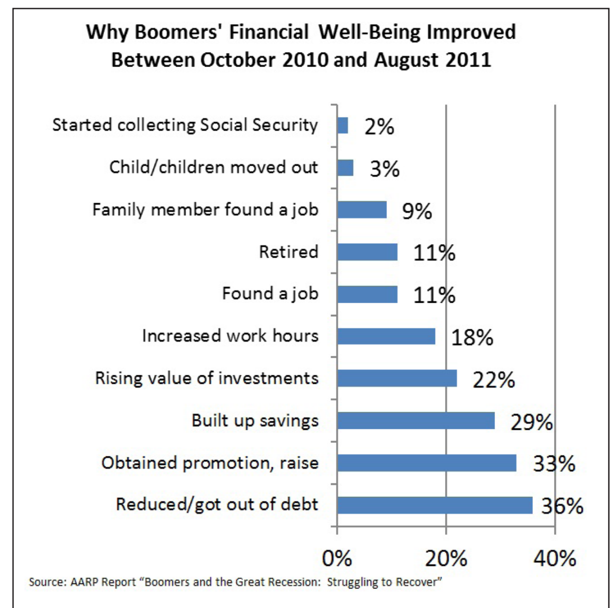


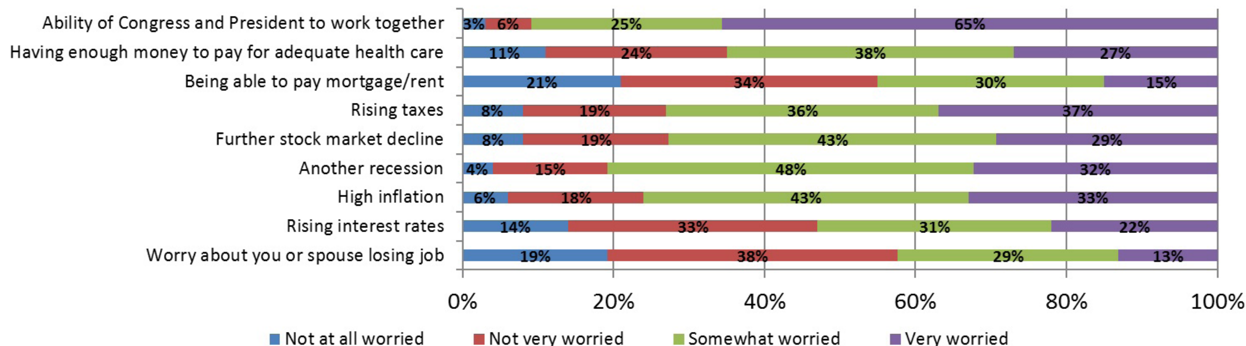


AARP Highlights

continued from page 22

Additionally, fewer Americans have the benefit of traditional defined benefit plans.

Boomers' experiences with job loss, lower wages, declining home values and investment losses has considerably dampened their retirement plans and expectations. So what have we learned based on the boomers' experience regarding retirement? To quote the report, "The result will likely mean longer work lives for those who can work and perhaps a reduction in anticipated living standards in retirement for those who cannot. At the very least, the study reveals considerable insecurity about retirement among boomers surveyed."



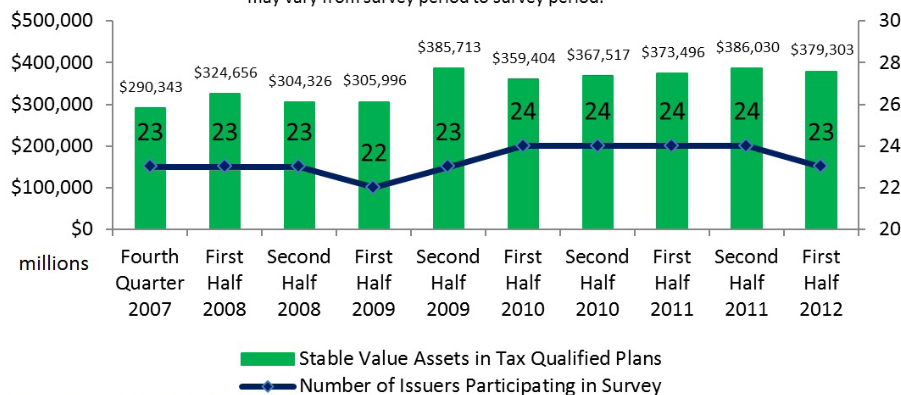
	Not at all worried	Not very worried	Somewhat worried	Very worried
Ability of Congress and President to work together	3%	6%	25%	65%
Having enough money to pay for adequate health care	11%	24%	38%	27%
Being able to pay mortgage/rent	21%	34%	30%	15%
Rising taxes	8%	19%	36%	37%
Further stock market decline	8%	19%	43%	29%
Another recession	4%	15%	48%	32%
High inflation	6%	18%	43%	33%
Rising interest rates	14%	33%	31%	22%
Worry about you or spouse losing job	19%	38%	29%	13%

SVIA-LIMRA Stable Value Sales and Assets Survey Shows Durability of Stable Value

By Gina Mitchell, SVIA

The SVIA-LIMRA Stable Value Sales and Assets Survey demonstrates the durability of stable value funds. The biannual Sales and Assets survey differs from other Association surveys, not only because it is conducted in partnership with LIMRA, but also because of the survey respondents. Most SVIA surveys focus on stable value managers. The Sales and Assets Survey respondents are the bank and insurance company issuers of stable value contracts. Because it looks at the industry through a different lens, the Sales and Assets Survey serves as yet another measure of the resiliency of stable value.

This Sales and Assets Survey looked at stable value during one of the most difficult periods for financial markets in our country's history. Participants were asked to provide information for an interval that began in the Fourth Quarter of 2007 when the financial crisis started, continued through the resulting Great Recession, and ended in mid-2012. Like other SVIA surveys, issuer participation may vary in each survey so some fluctuations in the data may be a result of this variation rather than an underlying trend or change.



Period	Stable Value Assets ($ millions)	Number of Issuers
Fourth Quarter 2007	$290,343	23
First Half 2008	$324,656	23
Second Half 2008	$304,326	23
First Half 2009	$305,996	22
Second Half 2009	$385,713	23
First Half 2010	$359,404	24
Second Half 2010	$367,517	24
First Half 2011	$373,496	24
Second Half 2011	$386,030	24
First Half 2012	$379,303	23

Looking at the Sales and Assets Survey data from the Fourth Quarter of 2007[1] through the First Half of 2012, reported stable value assets grew from $290 billion to $379 billion (up 31 percent).

The Sales and Assets Survey also highlights not only the returning prominence of insurance

continued on page 24

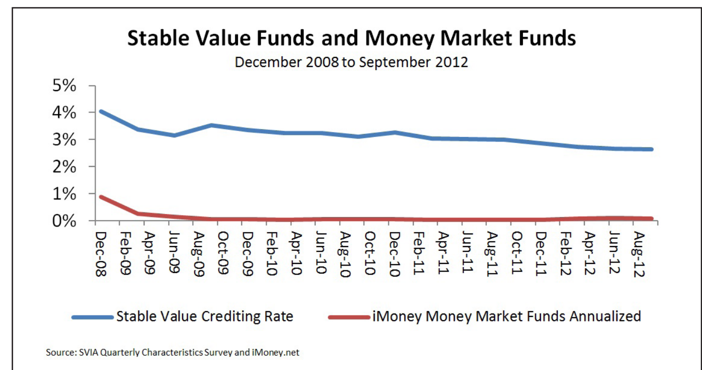
[1]The Fourth Quarter of 2007 was the last time the SVIA-LIMRA Stable Value Sales and Assets Survey data was conducted on a quarterly basis. Beginning in 2008, the Sales and Assets Survey became a biannual survey.

SVIA Quarterly Survey Shows Steady, Positive Returns and Steady Allocations

By Gina Mitchell, SVIA

SVIA's Quarterly Characteristics Survey demonstrates the virtues of stable value: consistent positive returns, principal preservation as well as having the least relationship or correlation to stocks as compared to other investments, which means stable value can act as a diversifier. For the third quarter of 2012, stable value fund assets included in the survey were $445 billion, with an average crediting rate (return) of 2.64 percent, which compares favorably with 0.08 percent annualized return for iMoney Net Money Market Funds.

The survey covers 16 quarters through the third quarter of 2012 and covers 23 stable value managers who now collectively manage $445 billion in assets. Assets have risen by 28 percent since the beginning of the financial crisis and the start of the survey, which began in the last quarter of 2008. Predictably, allocations made to stable value have held steady as the U.S. financial market has worked its way toward recovery. Comparing third quarter 2012 assets under management to previous years demonstrates this trend. Assets grew respectively by: 5.18 percent as of fourth quarter 2009, 0.41 percent as of fourth quarter 2010, and 1.24 percent as of fourth quarter 2011. The steadiness of assets under management from 2008 to date demonstrates a strategic allocation/response made by plan participants at the beginning of the crisis to blunt volatility and overall portfolio risk with stable value coupled with the trend towards more conservative investments as baby boomers move closer to retirement. SVIA



SVIA-LIMRA

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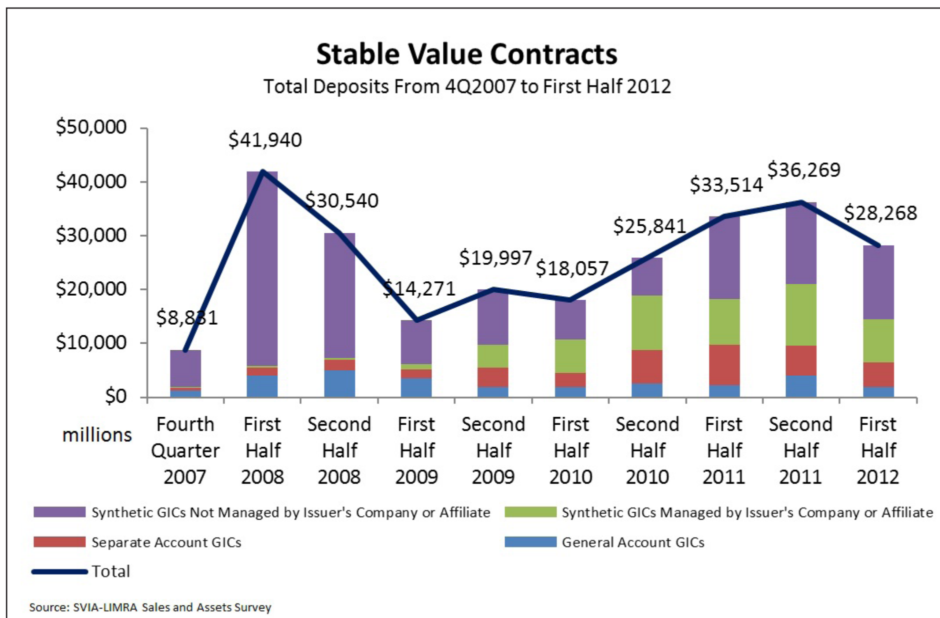
companies as issuers but also the increasing reliance on the insurance sector to provide a diversity of products: general account GICs, Separate Account GICs, and Synthetic GICs managed by an issuer's company or affiliate as well as Synthetic GICs not managed by an issuer's company or affiliate. While this last sector dominated stable value prior to the crisis, and it still commands $217 billion in stable value fund assets according to SVIA's Stable Value Funds' Investment and Policy Survey[2], in terms of new sales this sector has now been bested by stable value contracts that are both issued and managed by an insurance company or its affiliate. The Annual Stable Value Funds' Investment and Policy Survey also supports this observation by reporting that assets managed by insurance companies grew by 20% from 2010 to 2011 to $282 billion.[3]

Lastly, the Sales and Assets Survey also illustrates the industry's efforts to address capacity constraints caused by the financial crisis. The Stable Value Contracts chart shows that the stable value contract issuers have provided capacity throughout these uncertain times by providing a diversity of products. The chart also shows how much of this capacity is from insurance company issuers (General Account GICs and Separate Account GICs as well as Synthetic GICs managed by issuer's company or affiliate). The chart shows how contract capacity constricted in 2008 through 2010 and began to increase again heading into 2011 as new issuers, some bank issuers, and insurance company issuers brought capacity to the industry. SVIA



[2]SVIA's Stable Value Funds' Investment and Policy Survey surveyed 33 stable value managers by the type of stable value fund under management. The survey reported total stable value fund assets under management of $645.6 billion as of December 31, 2011.
[3]Ibid.