SVIA STABLE TIMES

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Auto-Balanced Fund Options: An Opportunity for Stable Value?

By Brian Murphy, AEGON Institutional Markets

The global migration from defined benefit pension structures to defined contribution retirement savings programs has been largely successful in transferring the liability of benefits and investment risk from the employer to individual plan participants. Yet, many participants who are now assuming the market risk on their retirement investments are either unprepared for managing this risk or have no desire to do so. For these participants, a growing number of plan sponsors are offering an option aimed at alleviating the burden of portfolio management altogether: auto-balanced funds.

Auto-balanced funds (which may also be described as Life Cycle, Life Style, Balanced, etc.) provide participants with a pre-selected mix of asset classes based on a general profile of

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Innovations in Employee 401(k) Education Meetings Increase Enrollments

By Charlene Galt, MassMutual

Many defined contribution plan sponsors struggle to increase their 401(k) participation rates. Most plan sponsors do very well if they reach a 75 percent enrollment of those employees who attend a retirement savings plan enrollment meeting. Even after employees are informed that the employer will match a specified percentage of their contributions (generally made on a pre-tax basis), many still do not participate in the 401(k) plan. Motivating employees to attend enrollment meetings has also been an issue for plan sponsors, particularly for those plans with enrollment of 50 percent or less. To address these concerns, employers have tried various techniques to improve poor attendance at enrollment meetings and encourage employees to enroll in their savings programs. This article discusses two such programs that aim to increase enrollment rates at employee 401(k) meetings: Transamerica Retirement Services' Plus 15 Participation Guarantee and MassMutual Retirement Service's[1] e4SM handheld wireless enrollment system.

Getting Them There

Some employers have made plan enrollment meetings mandatory for new hires. Others rely on managers to encourage employees to attend enrollment meetings, as well as to communicate the benefits of saving

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Economic Outlook

By Joseph G. Carson, AllianceBernstein

We expect real GDP growth to slow to 2.9 percent this year, down from last year's gain of 3.5 percent, led by a slowdown in consumer spending and housing. Growth this year should be dominated by business investment and exports, which will likely expand at least as fast as they did in 2005. We also see the target rate for fed funds ending the year at 4.75 percent, suggesting that there is just one more rate hike in the offing. Both calls are below consensus and appear to contradict recent relatively strong economic data as well as the market's expectations for several more official rate hikes this year.

The economic news since the start of the year has been very good, with many industries performing in line with or better than what we had expected. For instance, the January gain in employment, hours, and production (excluding utilities) reflects a solid rebound in first-quarter economic growth, suggesting that it will be at least as fast as our real GDP growth estimate of 3.75 percent annualized. The January industrial production report also shows evidence of the sector and industry rotation that we anticipate in 2006. For instance, business-equipment output rose a relatively strong 0.9 percent in January, indicating continued strong capital spending.

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Economic Outlook

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Elsewhere, there was evidence of weakening. Output of construction supplies was once again unchanged in January, following no gain in December. This was the first consecutive weak reading for this industry group since early 2003 and is consistent with what we see in other construction and housing-related indicators.

For instance, the Mortgage Bankers' weekly purchase index, which is relatively highly correlated with existing-home sales, has been trending lower over the past year. In mid-February, it hit its lowest level in two years (Display 1, *top*) New-home sales will also be affected as existing-home sales slow because many new-home buyers are sellers of existing homes. Not surprising, some home builders have reported declines in orders and more order cancellations in recent weeks. In February, the homebuilder's confidence index remained stuck at 57 (Display 1, *bottom*), unchanged from the readings of the past two months and the lowest level since 2001. Importantly, the subindexes tracking sales expectations and traffic of prospective buyers fell one point.

In January, home starts and permits rose to the highest level since 1973—appearing to contradict signs of a weaker housing market. We, on the other hand, believe that the January data were skewed by the record mild weather and will revert to a slowing trend soon.

Consumer-goods output, excluding the energy sector, did rebound in January, thanks to solid gains in many consumer durable-goods industries such as automotive products and appliances. January's gains, however, still left output well below its fourth-quarter average.

The strength of January's retail sales—up 2.3 percent—is the one outlier that challenges our forecast. Even excluding volatile auto-dealer sales, they rose 2.2 percent, far above our expectations—evidence of a buoyancy in consumer spending that we did not anticipate (Display 2). The gains were impressive across most major categories. For instance, clothing-store sales rose 4.2 percent; gen-

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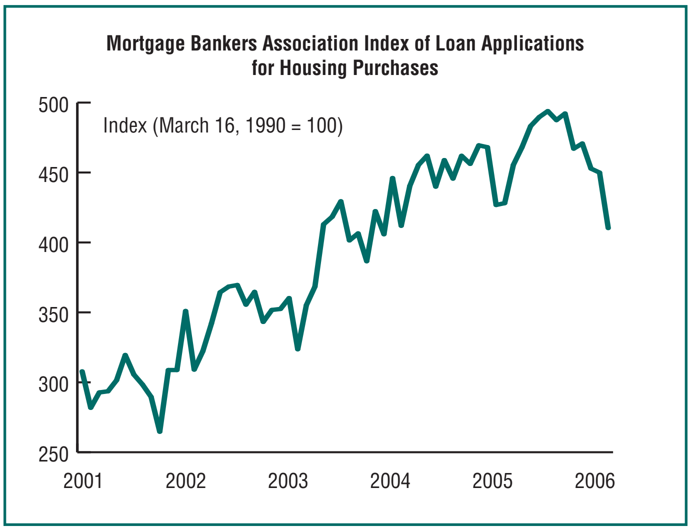
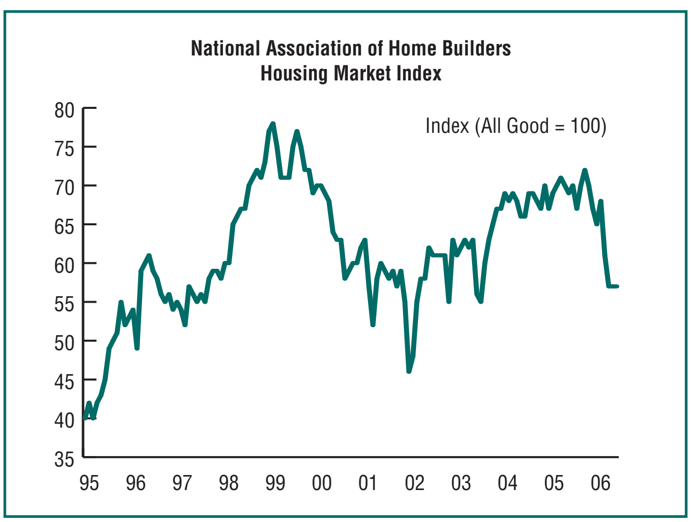
Display 1: Demand for Housing is Slowing, and Builders Are Less Optimistic





Housing demand appears to be slowing, as reflected in the Mortgage Bankers' purchase index, which has been on a downward path over the past year; in mid-February, it fell below the 400 threshold for only the second time in two years. Builders have responded to this slowing trend, evidenced by the 15-point drop in their optimism index over the past several months.

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Economic Outlook

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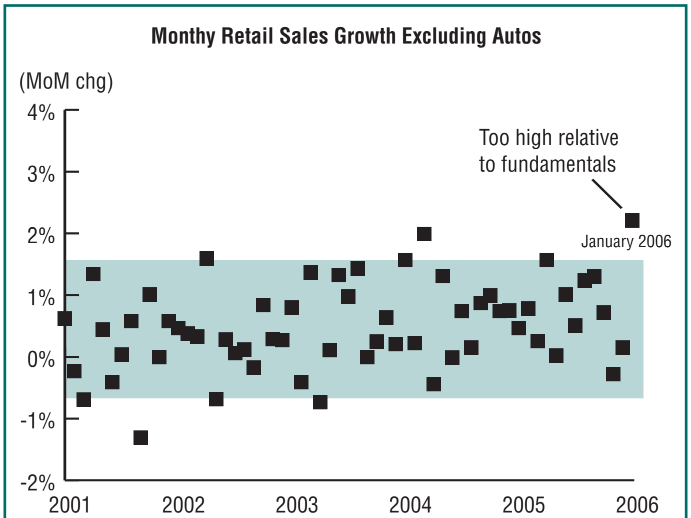
eral merchandise, 2.1 percent; furniture stores, 3.7 percent; motor vehicles, 2.9 percent; building and hardware stores, 3.4 percent; and eating and drinking establishments, 3.6 percent.

Rarely have the gains been so uniform. It was almost as if there were one or two extra selling days in the month, with each establishment benefiting just about equally. Perhaps this is what happens when the weather is warmer than expected: sales per day rise.

It's also possible that shopping patterns are undergoing a fundamental shift. January has historically been a month of low sales volumes and heavy markdowns following the big sales-volume months of November and December. Yet holiday gift-givers and consumers are now aware that many items are cheaper in January. As a result, more people give gift cards for the holidays, affording the recipients greater purchasing power once items go on sale, while others delay some regular purchases. Considering January's unseasonable warmth across the country, it would not have taken much of a shift to generate a major impact on overall retail sales.

While consumer sales trends look very robust today, we expect that February will mark the start of a slowdown in consumer spending—a trend that we expect to persist for the remainder of 2006. So far, February has been more typical in temperature terms. Moreover, February sales are unlikely to benefit from the gift-card phenomenon. We also expect consumers to start to feel the combined pinch of slower liquidity growth, lower home-equity borrowing, higher interest expenses, and higher energy bills.

Display 2: January Sales Were Lifted by Special Factors



Plot points depict the month-to-month percent change in non-auto retail sales for the last five years. Monthly outcomes that appear outside of the band of typical results tend to be followed by a correction within the following two months.
Source: Census Bureau, Haver Analytics and AllianceBernstein Fixed Income

January retail sales were very strong, helped by record warm weather and perhaps by a nascent shift in buying patterns. In the past, relatively large gains in retail sales have usually been followed by smaller gains or declines in the next month or two. We suspect that the reversal could be quite sharp because there are a number of fundamental factors weighing on consumer spending as well.

One More Rate Hike Likely in March

Barring any meaningful reversal in economic momentum, we think that it is probable that the Federal Reserve will raise rates once more at the meeting of the Federal Open Market Committee (FOMC) at the end of March. But this will likely be its final such move this year.

Ben Bernanke, the newly-appointed Federal Reserve chairman, gave a very balanced speech this week to the Senate Financial Services Committee, saying that he was comfortable with FOMC forecasts of real GDP growth of 3.5 percent in 2006 and 3-3.5 percent in 2007, and with its core-inflation estimates of 2 percent this year and 1.75-2 percent next year. He also agreed with the FOMC's assessment "that some further firming of monetary policy may be needed," adding that "monetary policy actions will be increasingly dependent on incoming data."

Importantly, Bernanke did not call the current pace of economic activity brisk or say that it threatens the balance of risk between growth and inflation—as his predecessor often did when telegraphing a further rate hike. Instead, he said that the most recent evidence on production, orders, employment, and retail sales "suggests that the economic expansion remains on track."

Perhaps this is Bernanke's way of conducting monetary policy: never giving signals or hints, the way Alan Greenspan did. On the other hand, this latter statement suggests to us that he also sees the January sales data as an aberration.

Mr. Bernanke also stated that he did not think that the current yield curve inversion was a harbinger of a sharp slowdown in the economy. According to him, an excess of saving relative to investment opportunities indicates that the yield curve is going to be flatter now than in the past.

We agree that increased global capital flows reduce the usefulness of the yield curve as a predictor of economic growth, and we do not see the curve inversion as a sign of an impending recession. However, our proprietary liquidity measure does suggest economic growth will slow this year. At this time, it is fair to say that only residential housing has confirmed our forecast, but this is significant because housing is such an important cyclical sector. Very often, its twists and turns are harbingers of change elsewhere in the economy.

Importantly, even though we see U.S. growth slowing in the coming year, we also see long yields rising a bit between now and year-end. Our research shows that U.S. interest rates are more closely tied to global interest rates, and with the Bank of Japan and the ECB expected to tighten monetary policy in 2006, we expect some of the rise in global rates to be reflected in the U.S. yield curve as well. With the flat yield curve causing forward interest rates to be at or below current rates, even our modest rate change forecast suggests that portfolio should maintain a short duration position.

Auto-Balanced Fund Options: An Opportunity for Stable Value?

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investor needs, e.g., risk tolerance, lifestyle, investment horizon, etc. These types of fund options will either automatically maintain the given risk-return ratio or become increasingly conservative as the account holder/beneficiary ages. Since the funds automatically rebalance based on pre-determined criteria, participants are relieved of the need to make individual buy/sell decisions.

Auto-balanced options have quickly gained significant traction in the defined contribution markets. Balances as of November 2005 are estimated to exceed $180 billion, with as much as 30 percent of defined contribution participants at least partially invested in this type of option. Additionally, auto-balanced options dominate some participant-directed markets, such as 529 college savings plans, where over 65 percent of all investments reside in age-based allocation options. The increasing popularity of these options is an example of a participant's aversion to asset management.

Critics of auto-balanced funds point out that, because these funds are rebalanced automatically in order to maintain the pre-defined allocation mix, it is possible that shares from a profitable asset class are rebalanced to an underperforming asset class. Other observers have noted that, by offering a "one stop" fund option, plan sponsors may be implying that they have a certain level of fiduciary responsibility regarding the performance of these investments. Additional criticism for use within 401(k)s is that they are often used improperly (i.e., people use the lifestyle funds along with a whole bunch of other options, thereby defeating the purpose). Also, these options usually add another layer of fees on top of the underlying investment expenses.

Scope of opportunity

Despite these concerns, there is every reason to believe that the popularity of auto-balanced funds will continue to grow, which makes them an attractive opportunity for stable value. The size of this opportunity can be estimated by looking at the current utilization of conservative asset classes with risk-return characteristics comparable to stable value, including money market funds and short to intermediate bond funds. Historically, stable value products have been a superior alternative to these conservative asset classes. Of the $180 billion invested in auto-balance funds in the defined contribution market, 15-20 percent, or approximately $30 billion, may be invested in allocations suitable for stable value.

Further, the unique characteristics of stable value make it ideally suited to the structure of auto-balanced funds. Conservative investment options are typically utilized in a significant capacity only toward the end of the accumulation cycle. Stable value's principal protection feature automatically locks in gains as assets are shifted to a more conservative position, and the book value liquidity feature can continue to provide growth and protection as the distribution phase begins.

Barriers to entry

Several challenges must be addressed if stable value providers are to gain entry into the auto-balanced fund segment. For example, stable value products are not registered, and published third-party due diligence or performance measures may therefore not be readily available to plan sponsors and/or participants. In addition, these funds are typically comprised of a collection of various mutual funds. The mutual fund format allows the manager to register the auto-balance fund and attract funding from various markets. Another important deterrent to including stable value in auto-balanced accounts is reliance upon optimization models to construct auto-balancing accounts. These models, as with most performance models, do not accurately capture the risk versus return characteristic of stable value and generally either underestimate the returns or overstate the volatility of stable value funds.

Although problematic, these issues are not insurmountable if plan sponsors, fund providers, and stable value providers work together to find appropriate solutions—but therein lies perhaps the biggest obstacle for stable value. The vast majority of auto-balanced fund options are available only through full service providers, simply because these firms have the greatest administrative resources necessary to manage these funds. Full service providers can also offer the underlying funds (in mutual fund format) within auto-balanced options. For this reason, they are simply not motivated to utilize any third-party funds, including stable value products.

In order to gain any significant funding from the auto-balancing segment, stable value providers must penetrate the full service providers and encourage the utilization of these products among non-full service providers.

Stable value provider perspective

The only remaining issue is the suitability of stable value within the auto-balancing products from the provider's perspective. Stable value providers should gain comfort from the fact that, at least in theory, auto-balanced funds should be less volatile than static stable value funds, since the raison d'etre of auto-balance funds is to make participant transfers and market timing unnecessary.

In addition, to the extent that there are interim transfers and withdrawals from a stable value account in an auto-balanced option, the movements should work inversely to those in a static stable value fund. Traditionally, stable value funds see heavy outflows after significant gains in the equity markets and heavy inflows following downturns in the market. Sitting alongside equity in auto-balanced options, however, stable value should see inflows to rebalance after large equity gains and outflows to rebalance following equity declines.

Despite the challenges stable value providers face in the auto-balanced segment, this market represents an attractive opportunity. Stable value has been proven to provide superior returns and lower volatility compared to the money market funds and bond funds. Therefore, utilizing stable value products to anchor the conservative allocation in auto-balanced fund options will enhance their overall performance and lower the relative volatility. SVIA

*Firms Give Life Cycle Strategies Another Look; Institutionalinvestor.com—Mutual Funds; May 4, 2005.

Why Investors Choose Stable Value

By Gina Mitchell

This article is reprinted with the permission of the Investment Management Consultants Association (ICMA). It also appears in IMCA's January/February 2006 issue of The Monitor.

Stable value is one of the most popular investments in defined contribution plans today. The Hewitt 401(k) Index™ reports that stable value funds represent roughly 20 to 25 percent of all defined contribution plan assets, even though not all plans have a stable value fund available. In fact, Hewitt reports that stable value's share of 401(k) assets are in line with the amounts invested in U.S. equities and company stock.[1]

So why do stable value funds attract such a large share of defined contribution investors' nest eggs?

The answer is that investors today have to shoulder most of the burden for saving and investing for their retirement, and they are very concerned about the risk of losing money in the stock and bond markets. Because stable value funds provide attractive and consistently positive returns, these funds have become an important tool with which retirement investors can build a more balanced and risk-controlled nest egg.

Stable Value Fund Characteristics:

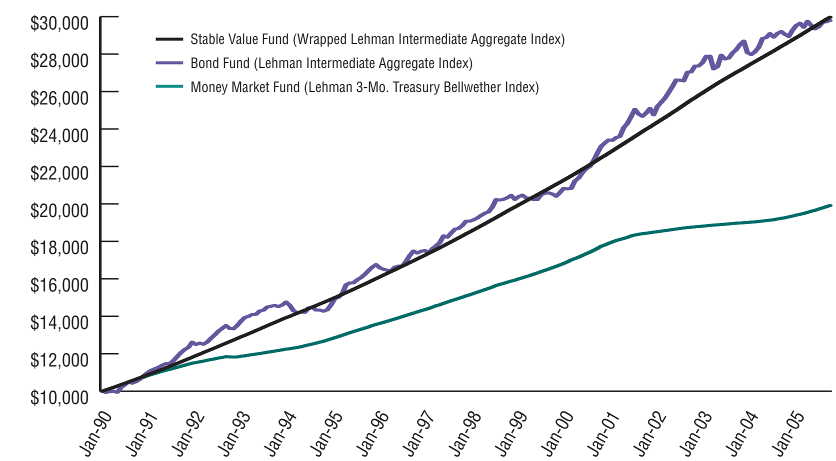
For more than thirty years, stable value funds have provided consistent performance for defined contribution retirement plan investors in public and private employer-sponsored retirement plans. Despite the ups and downs of the financial markets, investors in stable value funds have never lost money. By itself, this makes stable value funds very attractive to investors. But stable value funds provide other benefits as well:

- *Returns that are generally higher over the long-term than money market funds and cash.*

  Stable value funds outperform money market funds during most market environments, as illustrated in the following chart.
- Less risk to principal than bond funds.

  Stable value funds provide higher returns because they hold intermediate-maturity investments plus companion wrapper agreements that provide protection of principal and accumulated earnings for investors. As a result, stable value funds tend to produce long-term returns that are comparable to intermediate-maturity bond funds. Unlike bond funds, however, stable value funds do not fluctuate in value with changes in interest rates, so their volatility or risk is substantially less than that of a bond fund.

Stable Value Funds Earn Higher Returns than Money Markets 1/31/1990 to 2/28/2006



These characteristics help explain why, when defined contribution plan investors have access to a stable value fund, they allocate 33 percent of their total 401(k) savings to stable value.[2]

What Is a Stable Value Fund?

A stable value fund is a conservative investment vehicle that is available in more than half of all defined contribution employee benefit plans. It is used by defined contribution plan investors to provide principal preservation and stable returns that are in line with the long-term returns of intermediate bonds.

Stable value funds invest primarily in diversified portfolios of intermediate-duration, investment-grade fixed income securities. The average quality of these funds is typically AA+ or better. Stable value portfolios are covered by wrapper agreements that provide return stability and preservation of principal and accumulated earnings.

Why Investors Want Stable Value:

In addition to the desirable investment characteristics that stable value funds offer, there are several societal trends are fuel investors' consistent commitment to stable value: the equity bear market, the aging of the population, the shift in responsibility for retirement savings, and investors' awareness of investment risk.

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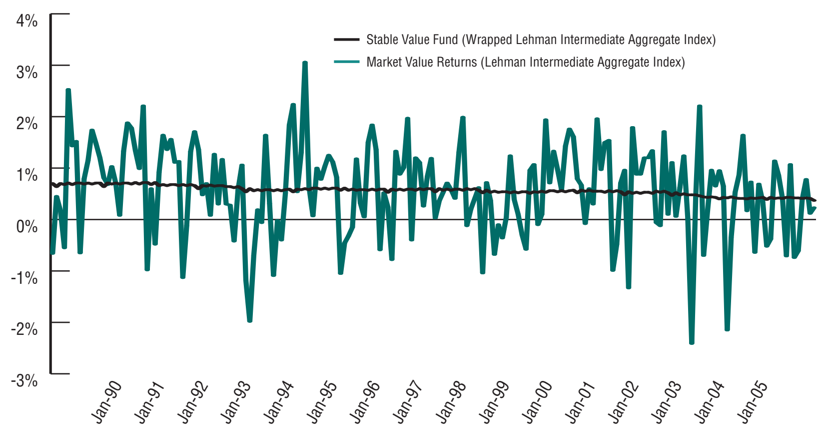
Stable Value Funds Are Less Volatile than Bonds 1/31/1990 to 2/28/2006



Why Stable Value?

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- *The Equity Bear Market Made Investors More Cautious.*

The recent bear market in equities caused many investors to recognize that it is crucial to have a balanced portfolio in order to protect their nest eggs from the volatility of the equity market. Flows into stable value funds increased significantly in the past several years as investors recalibrated their portfolios to include a higher percentage of conservative assets and bring their risk exposure in line with their true tolerances. To illustrate, the allocation to stable value funds of total defined contribution assets for plans participating in the SVIA survey grew from 23 percent in 1997 to 33 percent in 2002 and have stayed at that level since then.[3]

- *Stable Value Use Increases as Investors Get Older.*

Stable value is popular with investors of all ages, but as the chart below illustrates, it is most popular with older investors.[4] Allocation to stable value for the 60s age group reaches 21.0 percent compared to 12.1 percent for all ages in the survey.[5]

- *Investors Take on More Responsibility for Retirement Savings:*

The U.S. retirement system used to be described as a "three-legged stool" comprised of Social Security, an employer-provided pension, and individual savings. For this system to work, all three legs need to be equally strong and balanced. However, with the enormous financial pressures on Social Security and defined benefit pensions today, the U.S. retirement system is fundamentally out of balance.

Social Security is not sustainable under its current rules. Projections show that unless it is reformed, it will be able to cover only 74 percent of program costs after 2041, when the vast majority of baby boomers will be drawing benefits.[7]

Employer-provided pensions have also undergone a major transformation over the past 20 years. Increasingly, defined benefit plans that promise a percentage of salary as a retirement benefit have been replaced with defined contribution plans that provide a self-directed savings vehicle. This has shifted the investment risk from the employer to workers who have little investment experience or training.

An increasingly mobile workforce also means investors have a temptation to spend rather than preserve retirement savings each time they change jobs. In fact, the Congressional Research Service reports that 14.3 million workers have been faced with the choice of spending or rolling over retirement savings at least once since 1998.[8] The benefits of stable value are increasingly denied to job changing investors since investors roll over retirement savings predominantly into Individual Retirement Accounts (IRA).

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Average Assets of 401(k) Accounts by Participant Age, 2004[6]
Percent of Account Balances

Age	Equity Funds	Balanced Funds	Bond Funds	Money Market Funds	Stable Value Funds	Company Stock	Other	Unknown	Total
20s	51.6	13.0	9.0	5.1	6.0	12.6	1.3	1.4	100
30s	56.1	10.3	8.3	3.6	5.4	13.5	1.5	1.3	100
40s	50.9	10.2	8.7	3.6	8.4	15.4	1.7	1.1	100
50s	43.8	10.3	10.3	4.1	13.3	15.1	1.9	1.2	100
60s	36.5	9.5	12.3	4.8	21.	12.6	1.9	1.4	100
All	46.4	10.1	9.8	4.0	12.1	14.5	1.8	1.3	100

Appeal of Stable Value Fund Characteristics

Investment Characteristics	401(k) Investors	Retirees
Important to have some of your retirement money in investments that guarantee you will not lose your principal	63%	69%
Important that a portion of your money for retirement is in investments that provide a dependable rate of return	59%	66%
Important that you minimize the risk to your original investment	34%	54%

Why Stable Value?

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Additionally, almost half of the workforce, 51 million Americans, do not participate in or have access to a retirement plan. These individuals have been unable to utilize stable value funds to reduce risk and increase the returns on their retirement savings.

- *Investors Are More Aware of Investment Risk:*

All of these investors are hungry for investment vehicles that help to mitigate their investment risk without sacrificing returns, as evidenced by the popularity of stable value funds in 401(k) plans and the rapid growth in stable value funds. In fact, investors' sensitivity to risk was documented in the SVIA 2002 Conservative Investment Survey.[9] The survey found a surprisingly low tolerance for risk among 401(k) investors, with only 7 percent reporting they were willing to take a substantial risk for a substantial gain.[10] The majority (64 percent) of 401(k) investors were willing to take a moderate amount of risk in exchange for a moderate return. Twenty-eight percent said they would only take a small or minimum amount of risk, even if it reduced the money they would make on their investments.[11]

Not surprisingly, retirees are more risk sensitive than 401(k) investors since they have fixed incomes and readily understand that a loss can mean a reduction in their standard of living. The majority (58 percent) of retirees preferred a retirement investment portfolio that allows them to take the least amount of risk necessary to achieve a steady stream of income.[12] Only 37 percent of retirees were willing to take a moderate level of risk in order to receive moderate returns, and 1 percent reported a willingness to take a high level of risk in hopes of having high returns on investments.[13]

Stable value's characteristics of principal protection, dependable income generation, and diversification struck a cord with the majority of survey respondents: retirees and 401(k) investors as demonstrated in the table above.[14]

Can Stable Value Be a Wrong Choice for Investors?

Despite the trends discussed, stable value can be a wrong for investors focused only upon return. Clearly, return-driven-only investors should avoid stable value funds and other conservative investments, since they cannot provide the higher returns associated with higher risk investments.

Investors who want to market-time should also avoid stable value for two reasons. Stable value funds provide steady or 'stable' returns, which means that as interest rates rise, stable value will too. However, stable value funds can trail other conservative investments in a rapidly increasing interest rate environment. This characteristic also explains why stable value funds typically impose trading restrictions, which prevent arbitrage opportunities with other competing conservative investments like bonds or money markets.

Conclusion: Why Choose Stable Value?

Given our societal trend toward having workers bear the investment risk and responsibility for their retirement savings, an investment vehicle that provides bond-like returns, money market-like volatility and liquidity, and low correlation with equities is a critical tool in helping investors provide for their own retirement security. These investment attributes are present in stable value funds, which defined contribution investors have appreciated for more than thirty years. Clearly, stable value funds will continue to play an important role in helping Americans save for their retirement and achieve their goals for retirement security.

[1] Hewitt 401(k) Index™ Observations 1997 to November 2005.
[2] *Ninth SVIA Annual Stable Value Fund Investment and Policy Survey.* Washington, D.C.: Stable Value Investment Association, 2003, pages 1-3. The survey covers $419 billion in stable value fund assets offered in 97,854 defined contribution plans and representing a 33 percent allocation of total 401(k) assets as of December 31, 2004.
[3] *Seventh, Eighth and Ninth SVIA Annual Stable Value Fund Investment and Policy Survey,* Ibid., page 3.
[4] Investment Company Institute Perspective Web-Only Edition "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2004" by Sarah Holden and Jack VanDerhei, Volume 11, Number 4a, September 2005, page 15. The data summarized covers 2004 and 16.3 million 401(k) investors in 45,783 plans with $926.2 billion in assets.
[5] Ibid., page 15.
[6] Ibid., page 15. Please note that the ICI data on asset allocation to stable value differs from the SVIA survey data because the respective surveys cover different samples. The SVIA survey includes 97,854 plans, all of which have with a stable value option with total assets. The ICI survey includes four investment plan types, with only two containing a stable value option. The ICI reported that allocation to stable value rose respectively to 21.5 percent for plans that had equity, bond, money market or balanced funds, and stable value; and to 20.1 percent to plans that offered equity, bond, money market and/or balanced funds, company stock, and stable value.
[7] 2005 Annual Report of the Board of Trustees of the Federal Old Age and Survivors Insurance and Disability Insurance Trust Funds. Washington, D.C.: U.S. Government Printing Office, 2005.
[8] CRS Report for Congress, "Pension Issues: Lump-Sum Distributions and Retirement Income Security," Updated June 30, 2003, Patrick J. Purcell, Specialist in Social Legislation, Domestic Social Policy Division, page 8.
[9] SVIA Conservative Investment Survey. Washington, D.C.: Mathew Greenwald & Associates, Inc., June 21, 2002, pages 5-7. The survey focuses on trying to better understand the need for secure, low risk investments, as well as gauge the level of familiarity and appeal of stable value funds. Greenwald and Associates conducted the survey in May 2002 through a 15-minute national survey with 401(k) investors who participate in their employer's retirement savings plans and retirees who had saved at least $5,000 in their former employer's retirement savings plans.
[10] Ibid., page 19.
[11] Ibid., page 19.
[12] Ibid., page 42.
[13] Ibid., page 42.
[14] Ibid., page 66.

401(k) Education

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for retirement through their employer-sponsored programs to their team members. Yet others attempt to encourage employees to attend the meetings by offering beverages, snacks, or other incentives. Despite these efforts, some plan sponsors continue to express frustration with the results of their attempts to achieve a higher level of plan participation.

Why Participation is Important

Greater plan participation benefits more than just the individual employees saving for retirement. Plan sponsors and firms that invest and administer plan assets also benefit from greater participation by increasing the probability of meeting non-discrimination tests, which is an essential requirement in maintaining the 401(k) plan's tax-deferred status, as well as from the additional assets under management, which serve to create economies of scale.

Interactive Enrollment Approach

To help companies increase plan enrollment, Transamerica Retirement Services launched a new initiative in late 2005 guaranteeing a 15 percent increase in plan participation for companies who move their retirement plan to Transamerica. The Plus 15 Participation Guarantee is available for qualified new takeover plans currently struggling to meet their participation goals. In order to qualify, plan sponsors must have a current participation rate of less than 75 percent; make no material reduction to benefits from their current plan to the Transamerica plan; and ensure all eligible, non-participating employees attend a Transamerica enrollment workshop — the program's centerpiece — prior to the enrollment deadline.

During the workshop, Transamerica uses certified enrollers to walk employees though a five-step process that includes investment education, determination of personal risk tolerance, savings goals and selection of contribution percentages, and plan investment options. The objective of the meetings is for employees to leave enrolled in their company's retirement plan with an actionable strategy for their retirement savings.

Plan sponsors must also provide Transamerica with current participation data, which brokers will use to conduct a free analysis of the plan environment and create a customized report outlining recommendations of key participation drivers. Plan sponsors must select a minimum of four drivers, which may include the addition or modification of loan provisions, employer match, and automatic enrollment, among others. If participation fails to increase by 15 percent within the first quarter after transitioning to Transamerica, they will refund the first quarter's administrative fees to the employer.

"Having only launched Plus 15 late last year, we are delighted to have already had a number of clients complete the program, all of which have successfully increased their participation rates by at least 15 percent," said Kent Callahan, president and CEO of Transamerica Retirement Services. "Transamerica Retirement Services is committed to helping plan sponsors increase participation rates, and we remain confident in our abilities to design a plan that will meet the needs of our clients."

Easy-to-Use Technology As An Enrollment Tool

Technology is also proving to be an effective tool for increasing plan enrollments by eliminating participant inertia, a frequent roadblock to enrollment. MassMutual's e4SM, short for Electronic Enhanced Enrollment Experience, uses simple, handheld wireless technology to increase participation rates.

"Our e4 technology makes it easier for employees to join their company-sponsored retirement plan on the spot using a simple hand-held device. They don't have to fill out forms. They don't have to go home and think about it. They can make decisions right at the meeting with educational assistance from a MassMutual communications specialist. e4 puts control into the hands of the participant by leading them though every step of the enrollment process," explains Fred Castellani, executive vice president of MassMutual's Retirement Services Division.

Recognizing that participants have different levels of investment knowledge and that people generally interact with investment information in a variety of ways, MassMutual's e4 system provides three simple enrollment paths:

- "I know the way" is designed for confident investors who are comfortable analyzing information for themselves. Research and fact-gathering tools are available along with a complete listing of plan-specific investment options, including stable value.
- "I need a map" is customized for people who know about investing but need some guidance with their choices.
- "Show me the way" is the path for those who do not have the time or confidence to design their own investment portfolio. The process is made easier by providing retirement-year target horizon funds. Since these funds are not mutual funds, stable value can be used as a component of the target horizon fund. The stable value allocation under these investment options increases automatically as the targeted retirement date approaches.

Each of the investment options and asset classes offered under the retirement plan, including stable value, stand to benefit by attracting more assets with the addition of new plan participants or increased levels of contributions.

During the e4 enrollment session, prospectus materials are provided to the attendees, and a MassMutual communication specialist monitors each stage of the enrollment process. Communications and responses are appropriately tailored for approximately 20 individuals throughout the meeting, and individual participant concerns are also addressed. Larger enrollment meetings can be accommodated by holding multiple sessions with additional specialists available to assist with individual questions.

MassMutual's average e4 results are:

- 90 percent enrollment on the spot.[2]
- 100 percent of eligible plan sponsors elect e4 as their company standard for future enrollment and investment education meetings.

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401(k) Education

"Hard Close" Proposal Languishes at SEC

By Randy Myers

More than two years after proposing a new "hard close" rule to prevent late trading in mutual funds, the Securities and Exchange Commission (SEC) has yet to introduce it. Many retirement plan sponsors and fund industry executives are glad the Commission is moving slowly.

Late trading became an issue in 2003 after New York State Attorney General Eliot Spitzer filed charges that several mutual funds had allowed hedge fund manager Canary Partners LLC to buy shares in their funds after the stock market's 4 p.m. Eastern time close yet still receive that day's closing price. That was a violation of federal securities laws; it gave Canary the opportunity to trade on potentially market-moving news that came out after the market's close. If there were a very bullish development at 5 p.m., for example, Canary could buy fund shares and, with little risk, reap the benefits when the market moved higher the next day.

To guard against late trading, the SEC proposed in December 2003 that only trades received by a fund company or its transfer agent by 4 p.m. Eastern time could receive that day's price. It turned out, however, that such a rule would impact a whole host of investors who, unlike Canary Partners, weren't trying to trade on late-breaking news. Chief among them: investors in 401(k) plans, particularly on the West Coast. Even though they might place their orders with a plan administrator before the market's 4 p.m. close in New York, critics warned, their plan administrator might not be able to submit the order by that time, since it first had to comply with various recordkeeping and compliance requirements. That, the critics said, would mean retirement plan investors could lose access to the same-day trading privileges that other mutual fund investors enjoy.

Jaime Doyle, a spokesman for the Investment Company Institute (ICI), says that in response to this concern, the SEC has been exploring other possible approaches to preventing abusive late trading. "There may well be alternatives to the hard 4:00 p.m. close that provide effective safeguards while offering greater flexibility," Doyle says, adding that the ICI supports the SEC's deliberate approach to the issue.

In March 2005, in testimony before the Senate Committee on Banking, Housing and Urban Affairs, then-SEC Commissioner William Donaldson confirmed that the Commission was concerned a hard close might create difficulties for investors in some retirement plans and in different time zones. As a consequence, he said, the SEC staff was focusing on alternatives to its original proposal, including some that would rely on technology to ensure investors weren't taking advantage of late trading. "The technological alternatives could include a tamper-proof time-stamping system and an unalterable fund order sequencing system," Donaldson said then. "These technological systems could be coupled with enhanced internal controls, third party audit requirements and certifications." He also said that given the implications of the proposed rule, he had instructed the SEC staff to take "the necessary time" to fully understand the technological issues and "get it right." He said he did not expect a final rule until mid-2005.

Donaldson resigned in June of last year and was replaced by Rep. Christopher Cox, a California Republican. An SEC spokesman said in late February that the proposed ruling is still pending, but that no further information was available from the Commission.

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- 5-10 percent rollover leads. The transfer of rollover balances generated from e4 enrollments represents another valuable potential source of assets for plan administration and investment firms.

According to Ian Sheridan, vice president of marketing and business development for MassMutual Retirement Services, "e4 helps improve every step of the process for both participants and plan sponsors. After an e4 meeting, the plan sponsor receives a report detailing action taken by each employee without having stacks of paper forms to process. e4 helps plan sponsors reduce their administrative burden and meet their fiduciary obligations."

The e4 program provides MassMutual with valuable information about what features of the e4 enrollment process are most effective. One enhancement to e4, scheduled for release in early 2006, is designed to increase enrollment meeting attendance. The "Refer a Friend" feature will provide newly enrolled participants the opportunity to send a personalized e-mail message to a colleague recommending the e4 session. The premise is that employees are more likely to attend an enrollment session if their co-worker found the meeting to be a worthwhile and enjoyable experience.

The application of e4 as a tool to facilitate the education and enrollment of other savings plans, such as 529 college savings programs, is apparent. MassMutual is excited about opportunities e4 represents as a tool for different types of employee education and personalized messaging.

Transamerica's Plus 15 program and MassMutual's e4 have transformed the traditional enrollment meeting to a personalized and interactive experience for individuals. Plan sponsors are pleased with the resulting increase in participation. Each investment option offered under the qualified plan, including stable value, stands to benefit from increased deposits to the plan. Aware that the retention of their clients is based on their ability to deliver effective and innovative solutions to plan sponsors, service providers such as Transamerica Retirement Services and MassMutual Retirement Services strive to design solutions to meet their client's needs in an ever-changing environment.

[1]MassMutual Financial Group is a marketing designation (or fleet name) for Massachusetts Mutual Life Insurance Company (MassMutual) [of which Retirement Services is a division] and affiliates.

[2]Percentage of participants electing a contribution rate during a meeting that had a zero contribution rate prior to the meeting. Results from all e4 enrollment meetings presented by a MassMutual Communication Specialist, 1/1/05-12/31/05.

Defaulting Some 401(k) Investors into Diversified Funds Not Expected to Harm Stable Value Industry

By Randy Myers

The retirement plan market, it appears, is big enough for more than one investment strategy.

The U.S. Department of Labor is widely expected to endorse diversified investment portfolios, including lifecycle funds, as appropriate default investments for 401(k) plans once Congress gives the go-ahead as part of the pension reform legislation it's trying to hammer out right now. Yet retirement plan providers say they don't expect the move to have any dramatic impact on the use of stable value funds, which for the past two decades have been the most popular default investment option.

The investors most likely to be defaulted into an investment option, they note, are workers whose employers automatically enroll them in their retirement savings plans unless the worker specifically opts out. In most cases, industry experts say, those are younger workers at the lower end of the pay scale with consequently small account balances. Meanwhile, older workers with larger balances typically choose their own investment options and tend to appreciate the role stable value can play in their portfolios, especially as they approach retirement.

The proposed government endorsement of diversified portfolios comes at a time when much of the retirement industry has begun to question whether a conservative, single-asset class investment is the most appropriate choice for the average worker defaulted into a retirement plan, especially an investor with a long investment horizon. Two trends have contributed to this skepticism. One is the surging popularity of automatic enrollment; various surveys indicate that anywhere from 14 percent to 24 percent of plan sponsors now use it. Many more are expected to follow suit if, as is anticipated, Congress passes pension legislation this year and explicitly endorses the concept. That means plan sponsors could find themselves making default investment decisions for far more of their employees than they have in the past.

Also factoring into the new thinking on default investments is the growing popularity of lifecycle funds—diversified stock and bond portfolios with varying risk profiles that can be easily matched to an employee's age and investment horizon. Many retirement industry experts see the funds as a defensible default investment not just for young plan participants but for participants of any age. Retirement plan providers Fidelity Investments, Merrill Lynch, and Transamerica, among others, have gone on record backing diversified portfolios as default investment options. Without them, warns Kevin Crain, director of integrated benefits in Merrill's retirement group, many 401(k) plan participants will have scant chance of meeting their retirement savings goals.

Both the Senate and the House of Representatives have passed legislation that would direct the Department of Labor (DOL) to draft new and broader guidelines on default investments. Industry observers are optimistic that differences between the two versions will be reconciled this spring. In any event, the DOL has already begun work on such guidelines, and it seems inevitable that it will endorse lifecycle funds and similarly diversified investments. Less clear is whether the new guidelines will also mention stable value and money market funds. Bob Holcomb, vice president of legislative and regulatory affairs for JPMorgan Retirement Plan Services, says the DOL has been focused on the need for default investments that afford investors opportunity for capital appreciation—as has the language in the Senate's pension bill. But he says the language in the House bill reflects concern about both capital appreciation and capital preservation. "I think we're seeing more of a push now to make capital preservation part of the menu," he says. "I think the push is to broaden the menu of funds rather than be restrictive."

Regardless of what Washington does, many employers already plan to switch their default investment option to something more diversified. A Hewitt survey conducted late last year found that 17 percent of respondents were planning to change their default investment fund this year to either a balanced or asset allocation fund instead of a stable value or money market fund. Only 4 percent were planning to makes changes in the reverse direction.

As noted, though, even if many employers embrace lifecycle funds as their default investment option—and many retirement industry experts see no reason why they should not—it shouldn't sound the death knell for stable value. Other trends are at work in the retirement plan market that will continue to favor stable value investments, says Catherine Collinson, senior vice president for strategic planning at Transamerica Retirement Services. One important development is the massive wave of 76 million baby boomers now starting to reach retirement age. "These people typically are going to have larger account balances and unique needs which call for a more active approach to management, and allocation of their account balances outside of any default investment option," she says.

Meanwhile, Merrill's Crain notes that lifecycle funds aren't the only diversified investment option available to plan sponsors. Managed accounts are another; with them, the plan provider or third-party advisor uses a highly formalized investment methodology to construct custom, diversified portfolios for plan participants using the investment options already available in their plan. Often, that lineup includes stable value funds. "This has been a pretty quick trend," observes Crain. "We have about 25 percent of our plan sponsors who are adopting automatic enrollment—up from close to 0 percent two or three years ago—using our managed accounts program as their default investment vehicle. Our

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Pension Reform Could Hasten Exodus from Defined Benefit Plans to 401(k) Plans

By Randy Myers

If all goes according to the most optimistic of expectations, Congress will soon pass the most significant pension reform bill in a decade. If it does, it could accelerate the trend among American companies to stop offering traditional defined benefit pension plans in favor of defined contribution plans, such as 401(k)s.

When the House and Senate passed their respective pension bills late last year—HR2830, or the Pension Protection Act of 2005, and S1783, the Pension Security and Transparency Act—a key objective was to toughen funding standards for defined benefit plans. The Pension Benefit Guaranty Corp. (PBGC), the federal entity charged with backstopping the country's private pension system, recently reported that single-employer pension plans were underfunded by more than $450 billion as of September 30, 2005. Pumping up their coffers would lessen the risk of American workers being left without pension checks, but it would also ease the pressure on the PBGC itself, which is running a deficit of nearly $23 billion.

On the other hand, some employers confronted with growing pension liabilities and a requirement to pay higher insurance premiums to the PBGC—another feature of the proposed legislation—may simply throw in the towel and get rid of their plans altogether. In a recent survey of employers by asset manager SEI Investments, 78 percent of the respondents said pension reform will make plan management more complex, and 56 percent said their companies had already frozen or terminated pension plans or would do so this year.

Although passage of pension legislation of some kind is widely anticipated, the House and Senate bills diverge on important issues, making it difficult to predict just how much more complex plan management will become once House and Senate conferees have ironed out the differences between the two pieces of legislation. The Senate version is generally more onerous for plan sponsors, imposing, for example, stricter funding requirements for companies whose bond ratings stay below investment grade for two consecutive years and whose plan assets are less than 93 percent of the funding target. And while both bills would require companies to make underfunded plans whole within seven years, the House bill offers them some relief by allowing them to smooth their calculation of plan assets and liabilities using a three-year weighted average. That technicality would reduce the volatility of their funding requirements. The Senate bill, by contrast, permits smoothing over just a one-year period, limiting its impact on volatility. Melissa Kahn, vice president of government and industry relations for life insurance company MetLife, says the general expectation is that House and Senate conferees will split the difference between the two proposals and adopt a two-year smoothing period.

Other differences may not be so easy to resolve. The Senate, for example, has proposed that employers who wish to convert a traditional defined benefit plan to a cash-balance or similar hybrid format be required to offer certain protections to their existing employees, such as the option to choose between the two versions of the plan, or, for five years after the date of the change, receive the greater of their pension accruals under their old or new plan. The House bill contains no such protections. "This is probably one of the most contentious issues out there," remarks Bob Holcomb, vice president of legislative and regulatory affairs for JPMorgan Retirement Plan Assets. "Indications are the Senate is holding pretty firm on this issue, but nothing is a given." "My guess," adds Frank McArdle, manager of the Washington Research Office for human resources outsourcing and consulting firm Hewitt Associates, says, "is that the mandates desired by the Senate won't get through the conference committee unless there is some horse trading."

One potential beneficiary of any renewed push away from defined benefit plans could be the defined contribution plan industry. Employers who freeze or terminate their pension plans often make a concurrent effort to improve their defined contribution plans, where stable value products are a popular investment option. Case in point: International Business Machines Corp., which early this year announced that it would freeze its $48 billion U.S. pension plan in 2008 and enhance its 401(k) plan. It will, for example, double its current match on employee contributions to 100 percent on the first 6 percent of salary and make additional contributions unrelated to what workers kick in.

On the other hand, stable value stands to take a shot, albeit a small one, from provisions in the pension bills that would broaden the definition of investments appropriate for use as default options in defined contribution plans. Today, a majority of employers make conservative investments, such as stable value or money market funds, their default option for plan participants who don't take action to choose their own investments. But Congress, in its proposed legislation, is encouraging the Department of Labor to spell out that diversified investments, such as balanced or lifecycle funds, would be appropriate default options, too. Retirement plan providers say that even if employers embrace the change, it shouldn't have any immediate impact on the stable value industry. Investors who get defaulted into their plans are typically younger and at the lower end of their employers' pay scale; accordingly, their accounts represent a modest fraction of overall plan assets. In addition, balanced funds that are not composed of mutual funds can incorporate stable value investments into their portfolios. Indeed, Hewitt Associates, a human resources outsourcing and consulting firm that provides recordkeeping services for many large employers, recommends that its clients consider that approach. IBM already does that with

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Pension Reform

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four diversified "life-strategy" funds it offers to participants in its 401(k) plan.

The move to broaden the list of appropriate default investments goes hand-in-hand with another goal of the pending legislation: providing a fiduciary safe harbor for companies that automatically enroll employees in their retirement savings plan. It's an increasingly popular strategy, but one that many employers still shun because the protection from liability they enjoy under section 404(c) of the Employee Retirement Income Security Act exists only when plan participants choose their own investments. With automatic enrollment, many participants don't; they are slotted into their plan's default investment option.

To make automatic enrollment still more appealing to plan sponsors, both pension reform bills would also give ERISA preemption over laws in more than 30 states that prohibit employers from withholding money from employees' paychecks without their written consent.

Rick Lawson, vice president of federal government relations for Principal Financial Group, an insurance company and retirement plan provider, says these proposals, if adopted, will increase the number of employers willing to use automatic enrollment, and, as a consequence, boost the number of working Americans saving for retirement. A recent study by Hewitt Associates would seem to bear that out; about a third of the responding employers said they wanted to see the DOL issue guidelines on appropriate default investment options before they would adopt automatic enrollment, as well as ERISA preemption of state wage withholding laws.

While the House and Senate bills are closely aligned on the issues of automatic enrollment and default investment options, they diverge in other areas relating to defined contribution plans. For example, the House bill, championed by newly elected House Majority Leader John Boehner, R-Ohio, would make it okay for retirement plan providers to offer plan participants investment advice even when the provider has a financial interest in the funds it is recommending. The House bill mandates various disclosures by advice providers to alert investors to potential conflicts of interest. The Senate bill endorses the idea of offering advice to plan participants, but seeks to eliminate conflicts of interest entirely by specifying that it must come from an independent third party. While Boehner's recent election as House majority leader is generally seen as strengthening his hand in this fight, Washington observers are loathe to predict how the issue will be resolved. "I think both sides feel very strongly, so I don't know if a compromise can be reached," says Kahn. It's worth noting that while the lack of a legislative safe harbor for offering investment advice is cited by some employers as a reason not to make it available to their retirement plan participants, more than half already do so, according to a recent survey by *Plan Sponsor* magazine.

The House and Senate also are at odds over whether to extend the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001. The House has proposed to do so, the Senate hasn't. Among other things, EGTRRA increases contribution limits for retirement savings plans, allows workers over the age of 50 to make extra "catch-up" contributions to such plans, and provides a "saver's tax credit" for lower-income workers. It also authorizes the creation of Roth 401(k) accounts, which participants can fund with after-tax contributions in exchange for receiving tax-free withdrawals. EGTRRA expires in 2010 unless Congress acts to extend it.

"I think in theory both Republicans and Democrats support the extension of EGTRRA," Kahn says. "The sticking item is the cost. Right now, the cost of extending EGTRRA's pension provisions (in the form of lost tax revenues), without the savers' credit, is about $20 billion. And the savers' credit is about $10 billion. The Senate, in particular, I think is going to have concerns about that." Holcomb says the "time seems right" for extending EGTRRA but concedes that with Congress worried about the federal budget deficit, "nothing is for certain." McArdle says he's optimistic EGTRRA will be extended.

It may be some time before anyone knows the outcome. When the Senate and the House passed their respective pension reform bills late last year, there were widespread expectations that the differences between the two could be resolved as early as mid-March. By late February, however, legislators were still haggling over who would sit on the bicameral conference committee that will try to patch up the differences between the two bills. "I think a more realistic expectation is to look to an April time frame, possibly going into May," Holcomb says. "If it goes beyond May, I don't think it will happen which means we will have to start over after the mid-term elections."

No Harm in Default

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strong feeling is that this is the perfect solution because it offers a completely customized, personalized, target-maturity fund to participants that considers their individual characteristics."

Finally, although stable value funds are not represented in the lifecycle funds being marketed by mutual fund companies, there is no reason that plan sponsors could not create their own lifecycle offerings that do. In fact, Hewitt encourages it. "We've encouraged plan sponsors to use their own existing fund lineup to create these premixed portfolios," says Lucas. "One key reason is they typically have a stable value fund they can use for the fixed income component, which will generate a superior yield, in all probability, to what a money market fund would." Such an approach is especially practical, she says, for large employers that use privately managed commingled funds or separate accounts as their investment options. Those funds offer economies of scale, in terms of pricing, that are generally not available with mutual funds. "Plan sponsors have already spent a lot of time and effort vetting their existing funds," Lucas adds. "Their existing fund lineup is something they've selected because they believe they are the best investment funds that will fit their plan."

In short, stable value may no longer be the only kid on the block when it comes to choosing default investment options for 401(k) plans, but it looks to remain a vital part of the 401(k) investment lineup.

Despite Limited Appeal to Participants, Some Employers Embracing Roth 401(k)

By Randy Myers

While retirement industry experts expect the new Roth 401(k) accounts to appeal to a limited segment of the U.S. population, a small percentage of employers are making them available to their employees. In a survey of mostly large employers late last year by human resources outsourcing and consulting firm Hewitt Associates, 13 percent of the respondents said they were "very likely" to begin offering Roth accounts this year and another 21 percent said they were "somewhat likely" to do so. Among those who will: automaker General Motors Corp., which will make them available to more than 140,000 eligible employees beginning this summer.

Authorized by the Economic Growth and Tax Relief Act of 2001 (EGTRRA), Roth 401(k)s debuted this year after the U.S. Department of Treasury and the Internal Revenue Service finally issued final regulations for their use last December. (A summary of the regulations can be found at the Treasury's website at *http://www.ustreas.gov/press/releases/reports/roth401k_reg_attch.pdf.*) The accounts are much like traditional 401(k) plans but receive different tax treatment. Contributions to a traditional 401(k) are tax deductible, but withdrawals are taxable as ordinary income. Roth 401(k)s work exactly the opposite way; contributions are not tax deductible, but withdrawals are tax free once account holders retire, provided they are over the age of 59 1/2 and have had their accounts for at least five years. Federal law allows workers to contribute up to $15,000 to a 401(k) account this year, or $20,000 if they are age 50 or older. Workers can divide that amount any way they wish between a Roth and traditional 401(k), assuming their employer makes both types available. Many retirement plan providers are developing calculators to help workers make such decisions.

Like Roth IRAs, which were introduced in 1998, Roth 401(k)s will appeal primarily to investors who expect to be in a higher tax bracket in retirement than they are while working. Chris Bowman, vice president of retirement and investors services for Principal Financial Group, an insurance company and retirement plan vendor, says that's a limited audience. "Most people don't save enough for retirement, which means most people will have less income in retirement than they do today," he explains. "That means most people would be better off with a traditional 'k' plan." He estimates that only 10 percent to 15 percent of workers with access to a Roth 401(k) will take advantage of it.

That said, Bowman argues that it would be shortsighted for employers to deny employees access to a Roth 401(k) account, assuming their plan provider is able to handle the administrative details and the employer is prepared to educate employees about how the accounts work. After all, he notes, many of the employees who will want a Roth are likely to be highly compensated and hold key positions—employees, in other words, the employer may not want to alienate by denying them access to a benefit they want.

Some retirement industry experts predict the Roth 401(k) will appeal to an even wider array of workers, however. For example, employees who are concerned that they can't predict what their tax situation will be in retirement may choose to put at least some of their savings into a Roth 401(k). Then, depending on their tax situation after they stop working, they would have the flexibility to draw money from either type of account.

Bowman, who's firm caters primarily to small employers, says that by mid-February about 5 percent of the company's plan sponsor clients had requested amendments to their retirement plan documents that would allow them to offer a Roth 401(k), and those requests were becoming more frequent. "I wouldn't be too surprised if we ended up with 50 percent or better in terms of how many put it into their program," he says.

Catherine Collinson, senior vice president for strategic planning with Transamerica Retirement Services, says her firm, too, has seen a high level of interest from smaller plan sponsors, but adds that with the Roth 401(k) regulations finally here, many are now weighing the pros and cons of the accounts before proceeding to offer them. While appealing to employees destined for a higher tax bracket in retirement, she explains, the accounts also will impose additional administrative work on employers. "It's fairly complex in terms of the employer's obligations," agrees Kerrie Richter, vice president of products and marketing for Ameriprise Retirement Services. "You need to update your Summary Plan Descriptions and make sure those get sent to all employees. You have to modify your recordkeeping system to handle the different types of pre-tax and post-tax contributions, and that affects payroll systems and complicates ADP (actual deferral percentage) testing. You've also got to educate employees about the new offerings and update employee access points such as your Website, account statements and call center, where your training needs to be updated. As providers incur costs in these areas, some of that transfers to sponsors, and that's a consideration."

Other employers worry that after they go through all that trouble, Roth 401(k) accounts may disappear anyway. EGTRRA, the legislation which enabled the accounts, is set to expire in 2010 unless Congress intervenes to extend it. While the House has passed legislation that would do just that, the Senate, concerned about its costs, has not; the two chambers are trying to work out their differences on that and other pension reform legislation right now. Retirement plan providers predict that if EGTRRA isn't extended, existing Roth 401(k) accounts and their tax benefits wouldn't disappear. Rather, they expect, workers simply wouldn't be able to make any more contributions to them, nor could workers open new Roth accounts.

Apart from concerns about administrative burdens and the tenuous legal status of Roth 401(k) plans,

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EBRI/ICI Report on 401(k) Plans

By Gina Mitchell

Everyone knows that defined contribution plans play an increasingly important role in Americans' retirement security. However, only one group can provide the details for 40 percent of the estimated 43 million workers who participated in 401(k) plans at year-end 2004 and invested over $926 billion in assets. Needless to say, the Employee Benefit Research Institute (EBRI) and Investment Company Institute (ICI) Participant-Directed Retirement Plan Data Collection Project for 2004 provides a wealth of information on not only how 401(k) investors are doing, but also on how they have reacted to the challenges of the financial markets in planning for their retirement security. This article highlights some of the general trends from the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project and also highlights the study's findings on stable value funds.

EBRI/ICI Project Demographics

The following table provides an interesting overview of the plans, number of participants, total assets, and average account balances in the Project. As expected, the largest plans, those with over 10,000 participants, dominated the Project universe and accounted for 47 percent of participants and 55 percent of total assets even though they represented only 1 percent of overall plans in the Project. Conversely, plans with less than 250 employees represented 80 percent of the plan universe, 11 percent of participants, and 8 percent of assets. *(See table below.)*

EBRI/ICI Project Compared to SVIA

SVIA's Ninth Annual Investment and Policy Survey for Stable Value Funds as of year-end 2004 covered almost 98,000 plans, all of which offered a stable value fund as part of their investment option menu. The survey reported over $419 billion in stable value assets. Within the Project universe, only 55 percent of plans offered a stable value fund as part of their investment option menu. The Project also found that almost 55 percent of participants had access to a stable value fund investment option. On an asset basis, almost 59 percent of the assets covered in the Project had a stable value fund investment option available. The Project also reported that overall asset allocation to stable value was 12 percent, or $110 billion. *(See charts on page 15.)*

Overview of Asset Allocation

The Project observed that 401(k) participants' asset allocation was consistent with a long term investment horizon given a higher allocation to stocks (equities and company stock) and that allocation changed slightly over the past eight years. They also found that Life Style[1] and Life Cycle funds[2], which are included in the Project's balance fund category, had grown steadily over the eight years. *(See chart on page 15.)*

In fact, the observation that asset allocation was consistent with a long-term investment horizon is demonstrated when asset allocation is reviewed based on the age of investors. The Project reported that equity investment remains most popular with younger workers. Conversely, as investors mature, their equity allocation decreases and their investment allocation to conservative options—stable value, bonds and money markets—increases. *(See table on page 16.)*

Asset Allocation, Investment Menu, and Age

A key determinant of asset allocation is what is offered in the investment option menu. As discussed earlier, only two out of the four investment option menus covered in the Project included stable value. The

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EBRI/ICI Project Demographics for Year-End 2004

Number of Plan Participants	Total Plans	Total Participants	Average Total Assets	Account Balance
1 to 10	8,150	50,226	$2,038,139,848	$40,579
11 to 25	11,531	197,884	$7,258,784,792	$36,682
26 to 50	8,679	313,979	$11,552,285,508	$36,793
51 to 100	6,448	456,906	$17,318,759,431	$37,904
101 to 250	5,314	835,379	$32,688,724,463	$39,130
251 to 500	2,291	807,147	$32,233,557,057	$39,935
500 to 1,000	1,297	909,790	$40,878,998,369	$44,932
1,001 to 2,500	1,053	1,617,265	$77,549,915,916	$47,951
2,501 to 5,000	488	1,707,624	$92,557,080,626	$54,202
5,001 to 10,000	246	1,710,746	$102,557,522,870	$59,949
>10,000	286	7,676,948	$509,538,716,887	$66,375
All	45,783	16,283,894	$926,172,485,767	$56,878

Embracing Roth 401(k)s

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some plan sponsors worry the accounts will add another layer of complexity to their retirement plans, which could alienate some workers. Research suggests that when people have to make too many decisions about investing in their retirement plan, some throw up their hands and simply choose not to invest at all. "We don't want to go into Roth paralysis," Bowman says.

Lori Lucas, director of participant research for Hewitt Associates, predicts that many employers will take a wait-and-see approach to the Roth 401(k). They'll look at the utilization rates early adopters experience, she says, and if they are strong, and if plan participants aren't being confused by the accounts, more employers will offer them. In addition to watching how General Motors fares, they will also be able to look to a handful of other large employers who have embraced the Roth, including financial services firms Vanguard Group, A.G. Edwards, and Hewitt Associates.

Regardless of how broadly the new accounts are adopted, retirement industry experts don't foresee them having a dramatic impact on the stable value industry. They note that plan sponsors are expected to offer the same investment lineup for their Roth 401(k) accounts that they offer in their traditional 401(k) accounts, and that stable value investments offer the same benefits to investors in either type of account. Managers of stable value assets won't have to do anything special to accommodate inflows from Roth 401(k) accounts; plan recordkeepers will simply need to keep track of whether participants' contributions are allocated from a regular or Roth 401(k) account. SVIA

EBRI/ICI Report

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Project found that the average asset allocation for plans with a stable value fund increased substantially from the Project-wide average of 12 percent to 21.5 percent in plans with stable value and to 20.1 percent in plans with stable value and company stock.

As reported earlier, as investors' age, they decrease their allocation to equities (equities and company stock) and increase their allocation to conservative investments (stable value, bond, and money market funds). The Investment Menu and Participants' Age Influence Asset Allocation table shows not only this shift to conservative investments but also demonstrates that when stable value funds are available, they gather the lion's share of assets among their conservative counterparts.

As investors age, stable value funds also tend to fare well compared to balanced funds in terms of attracting assets. As the table shows, stable value allocations exceed balanced funds for age groups 30 and above.

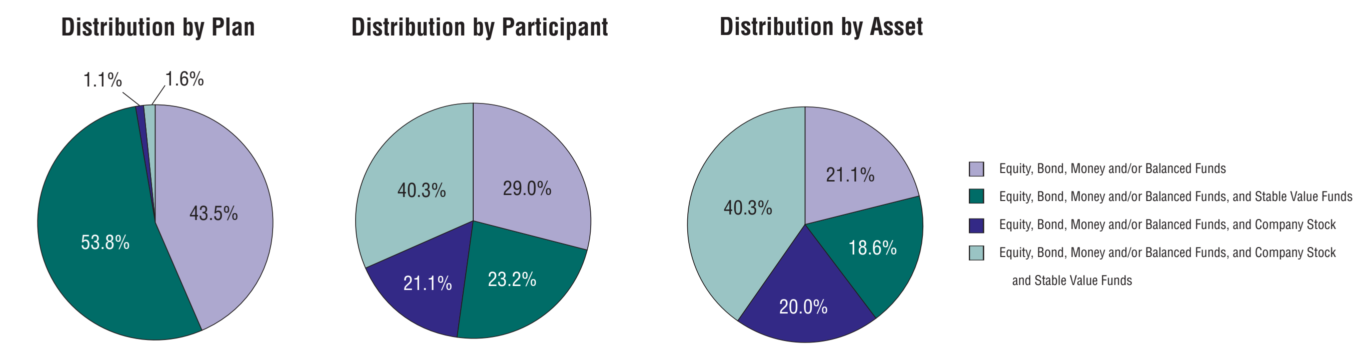
The table also demonstrates another observation for stable value funds. That is, stable value is often used by 401(k) investors to complement allocations to company stock. *(See table on page 16.)*

Account Balances and Savings

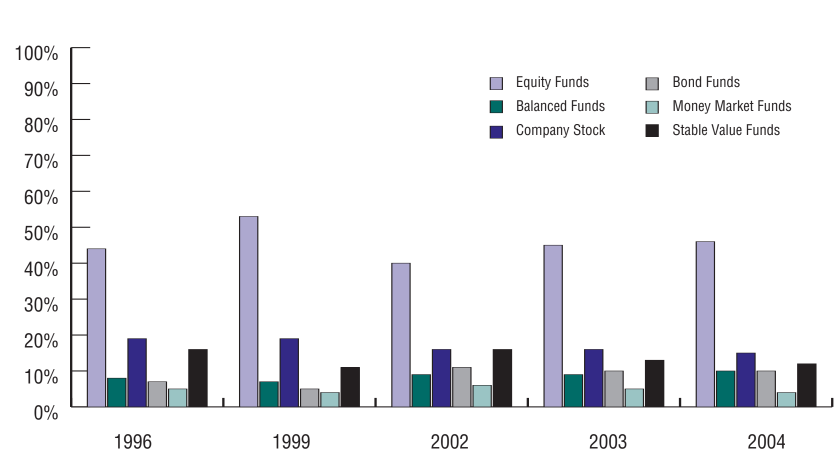
The Project reported that the average 401(k) account balance of all participants at year-end 2004 was $56,878, up from the year-end 2003 level of $51,569. When a consistent sample representing 40 percent of all participants in the Project was compared, the Project reported that average account balances increased 36 percent, rising from $67,016 in 1999 to $91,042 in 2004. The Project says that in 2004 alone, the average account balance among this consistent group of participants increased 15 percent, due in part to positive equity returns. The Project also attributes this growth to net contributions each year and stock market appreciation since 2002.

The news was not all rosy for the consistent sample group. The Project found that average account balances of older workers had not yet recovered from the impact of the bear market. They reported that for the 60s age group, average account balances were still down by nearly 5 percent in 2004 compared to 1999. They explained that the slower recovery reflected the key role that investment returns play on these typically larger account balances, while annual contributions are able to provide only a minor boost to large account balances. Finally, in some cases, older workers were starting to withdraw from their 401(k) account balances.

Distribution of 401(k) Plans, Participants by Investment Options, 2004



Asset Allocation 1996 to 2004



Conclusion

Defined contribution plans are a major source of retirement security. The EBRI/ICI Project shows that 401(k) investors are taking advantage of their 401(k) plans and investment options. The Project demonstrates that when stable value funds are available, they are the preferred choice among conservative investment options. Clearly, stable value funds will continue to play a major role in helping 401(k) investors achieve retirement security.

Investment Menu and Participants' Age Influence Asset Allocation

Average asset allocation of 401(k) accounts by participant age and investment options, percentage of assets.*

ALL AGES COMBINED	Equity Funds	Balanced Funds	Bond Funds	Money Market Funds	Stable Value Funds	Company Stock
Equity, Bond Money and/or Balanced Funds	58.5	12.9	17.5	6.6		
Equity, Bond Money and/or Balanced Funds, and/or Stable Value Funds	25.4	12.6	6.7	3.6	21.5	
Equity, Bond Money and/or Balanced Funds, and Company Stock	42.3	8.0	14.0	5.9		26.6
Equity, Bond Money and/or Balanced Funds, and Company Stock, and/or Stable Value Funds	39.2	8.6	5.3	1.9	20.1	22.8
Plans without Company Stock and Stable Value						
Age Group						
20s	60.6	15.7	13.6	7.2		
30s	66.4	12.3	12.8	5.2		
40s	63.2	12.7	14.6	5.6		
50s	55.8	13.4	18.8	6.9		
60s	47.5	12.8	25.1	8.6		
Plans with Stable Value						
Age Group						
20s	56.4	14.6	7.6	4.4	12.8	
30s	62.1	12.6	6.8	3.3	11.5	
40s	57.9	12.7	6.6	3.3	16.0	
50s	50.3	12.8	6.8	3.6	23.3	
60s	41.1	12.0	6.6	4.1	33.4	
Plans with Company Stock						
Age Group						
20s	48.1	8.6	9.9	6.5		25.4
30s	50.8	7.2	9.2	4.8		26.1
40s	45.8	7.5	11.0	5.3		27.8
50s	39.9	8.3	14.9	6.4		27.2
60s	34.7	8.5	21.7	7.3		23.4
Plans with Company Stock and Stable Value						
Age Group						
20s	43.6	12.3	5.8	2.9	10.0	23.1
30s	48.2	9.3	5.4	1.9	9.1	23.8
40s	43.9	9.0	5.3	1.8	13.6	24.1
50s	37.2	8.7	5.5	1.9	21.5	23.1
60s	29.9	7.1	4.7	2.1	34.5	19.8

Equities Allocation Decreases and Conservative Allocations Increase with Participants' Age

Age Group	Equity Funds	Balanced Funds	Bond Funds	Money Market Funds	Stable Value Funds	Company Stock	Other	Unknown	Total
20s	51.6	13.0	9.0	5.1	6.0	12.6	1.3	1.4	100
30s	56.1	10.3	8.3	3.6	5.4	13.5	1.5	1.3	100
40s	50.9	10.2	8.7	3.6	8.4	15.4	1.7	1.2	100
50s	43.8	10.3	10.3	4.1	13.3	15.1	1.9	1.2	100
60s	36.5	9.5	12.3	4.8	21.0	12.6	1.9	1.3	100
All	46.4	10.1	9.8	4.0	12.1	14.5	1.8	1.2	100

Average Account Balances by Age

Age Group	1999	2000	2001	2002	2003	2004
20s	$10,410	$13,111	$15,698	$16,472	$25,046	$31,844
30s	$37,514	$39,204	$40,333	$37,957	$52,793	$63,710
40s	$70,092	$70,620	$70,011	$64,643	$85,320	$100,106
50s	$107,495	$104,187	$100,914	$92,441	$115,605	$129,218
60s	$143,161	$132,840	$125,376	$113,627	$130,788	$136,400
All	$67,016	$66,649	$65,865	$60,926	$78,983	$91,042

[1]Life Style funds are those that are tailored to an individual's specific risk tolerance and reflect that risk level. Typically, they are tailored to offer a conservative risk, moderate risk, and aggressive risk.

[2]Life Cycle funds adjust risk over time based on an individual's age and/or investment horizon. They typically rebalance portfolios to become more conservative and income-producing as an individual ages or gets closer to retirement.