SVIA STABLE TIMES

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IN THIS ISSUE

Mark your calendars!

On Monday, September 15th, the nomination process to fill five board seats *(four service firm & one plan sponsor)* will begin. Even those running for a second term will need nominations.

Making Retirement Income Security Work

By Randy Myers

Stable Value Investment Association Chairman James King is proud to be part of the stable value industry. "It is an important asset class, and it's part of the fabric of defined contribution plans," he said as he welcomed his industry colleagues to the SVIA's 2014 Spring Seminar in April. "We should be proud of being stewards of stable value, and of bringing it to retirement plans in the American workplace."

King, also managing director and senior client portfolio manager in the Stable Value Markets Group at Prudential Financial, isn't alone in having good feelings about the industry in which he works and the products it delivers. Last year, the SVIA polled 29 firms that have been providing stable value products consistently since 2007. By year-end 2013 those firms had $702 billion in stable value assets under management, representing about 12 percent of the total assets in defined-contribution retirement savings plans. That was up from just over $459 billion at year-end 2007.

That's solid growth, and it demonstrates that retirement plan participants see a lot of value

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The 2014 Elections and What Will They Mean

By Randy Myers

Could a Republican takeover of the U.S. Senate make it easier for President Obama to get things done? Republican businesswoman Gwendolyn King, president of the Podium Prose speakers bureau and a former Social Security commissioner, thinks it's possible.

Republicans already control the House. Conventional wisdom posits that gaining a lock on both chambers of Congress would make it even more difficult for President Obama to carry out his agenda in the final years of his second term.

Gwendolyn King isn't so sure. Addressing the 2014 SVIA Spring Seminar, Mrs. King said that if the GOP takes the Senate, Obama could indeed wield his veto pen regularly, extending the political gridlock that has gripped Washington. Or he could move toward the center of the political spectrum in a bid to find common ground with Republicans, move some key legislative initiatives forward, and develop his legacy.

That sort of compromise isn't impossible, King insisted. "Bill Clinton, even when he

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A Predictable Surprise: The Unraveling of the U.S. Retirement System

By Randy Myers

If you think it's harder for the average American to build a financially secure retirement today than it was a few decades ago, you're probably right. But the usually cited culprits—the ongoing demise of the defined benefit pension plan, the failure by many individuals to adequately fund their defined contribution plans—aren't solely to blame. So too, says Sylvester Schieber, is the shaky state of the Social Security system, which will pay most Baby Boomers less than they put into the system.

Schieber is a former chairman of the Social Security Advisory Board and the author of *The Predictable Surprise: The Unraveling of the U.S. Retirement System* (Oxford University Press, 2012). Speaking in April at the 2014 SVIA Spring Seminar, Schieber noted that an average earning single male retiring in 1975 at the age of 65 could expect to collect, on average, $108,838

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Save the date: SVIA National Fall Forum, October 13-15, 2014 in Washington, DC

Making Retirement Income Security Work

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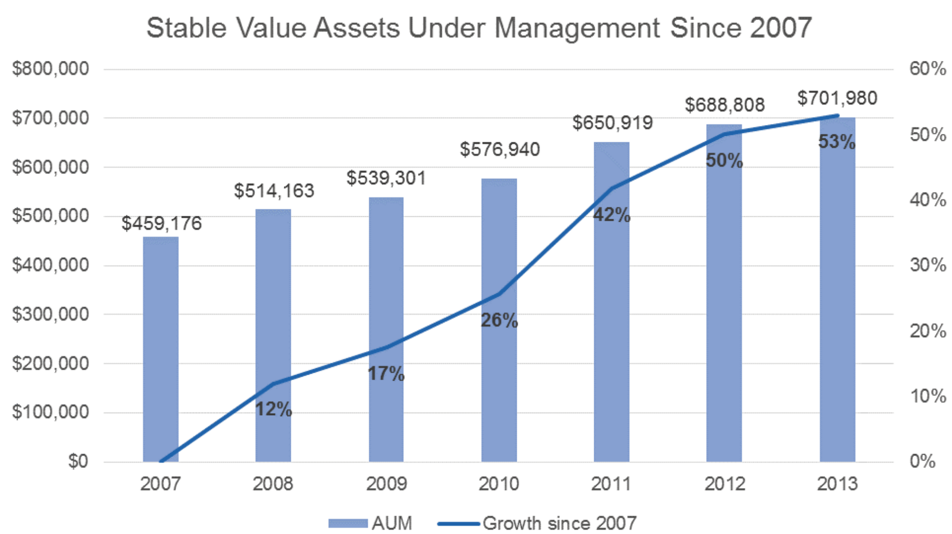
in stable value funds. But King is encouraging his industry colleagues to deliver even more for plan participants, in part by looking for creative ways to grow the industry. A good start, he suggested, would be to find ways to include stable value funds more frequently in target-date funds. Target-date funds are one of the fastest-growing investment options in defined contribution plans, but most are structured as mutual funds. Stable value is not available in mutual funds, however, stable value funds can be incorporated into customized target-date funds that are structured as collective investment trusts. Many larger plans already operate custom target-date funds with a stable value component. "Using stable value in place of, or as part of, the fixed-income component of target-date funds can make a positive contribution to the performance of those funds and their Sharpe ratios," King said.



King also encouraged his colleagues to take note of the growing trend among plan sponsors to reenroll their employees into their defined contribution plans, typically slotting employees into the plan's default investment option unless they opt to allocate their money differently. In most cases, that default investment option is not a stable value fund but a target-date fund. "Stable value is too good and essential an asset class to allow this. As an industry, we need to have simple and available solutions that include stable value in these asset-mixed investment vehicles for plan sponsors to offer. And, these solutions must permit participants to continue to rely upon stable value for its diversification benefits, principal preservation and positive, conservative returns." King said. SVIA

A Predictable Surprise

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more in Social Security benefits than he had paid into the system, in 2013 dollars. By contrast, an average-earning single male retiring at age 65 this year can expect to collect $85,011 *less* than he paid into the system—a swing of nearly $200,000. For a high-earning couple, the difference could be nearly a million dollars.

Franklin Roosevelt, Schieber said, tried to warn us. When the Social Security Act passed in 1935, it was written so that Social Security would be a fully funded program in which the government held reserves adequate to pay out future benefits—an approach Roosevelt strongly endorsed. Liberals soon balked, though, because they didn't want to wait 40 years to build up reserves; they wanted to start paying benefits immediately. Conservatives weren't enthusiastic either. "They worried about what kind of malarkey future Congresses could get into with all those assets sitting around," Schieber noted. As a result, Congress repeatedly rolled back Social Security's funding provisions, and by the early 1950s the program was operating on a pay-as-you-go basis.

That worked for a while, because there were more people contributing to the system than there were collecting benefits. But by the mid-1970s that ratio had inverted, putting the whole program under increasing financial strain. In 1977 Congress cut Social Security benefits and raised taxes, and in 1983 it raised taxes again and initiated taxation of Social Security benefits. But it did not move nearly far enough to put the system on sound financial footing. Today the program would need an immediate injection of about $10.5 trillion to operate smoothly for the next 75 years, Schieber said. It will need

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The 2014 Elections

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was impeached by the Republicans, found a way to work out a budget deal and to do reform on Welfare," she said. "It happened with George Bush as well. And it happened with Ronald Reagan when he and Tip O'Neil got together and worked out a budget deal and reform of Social Security."

King said she thinks it is "almost a slam dunk" that Republicans will win majority control of the Senate this year, although she conceded that the party has found ways to lose seemingly winnable elections in the recent past.

Colbert King, a Democrat, Pulitzer-Prize-winning *Washington Post* columnist and Gwendolyn King's husband, isn't convinced that his party is about to relinquish the reins of the Senate. Joining her on the SVIA stage, he reminded his audience that "in politics, overnight is a lifetime. The way things look today may not be the way things will become [in] November." While Republicans have been hammering Democrats over the new healthcare law, for example, King noted that more than eight million people have signed up for health insurance under the law and that public sentiment seems to be shifting in favor of President Obama's signature legislative accomplishment. "It has a growing number of supporters, which tends to neutralize the opposition that Republicans would mount against it," King said. He also noted that it's impossible to predict what might happen in countries outside the U.S. between now and the November midterms that could alter the prospects for either party.

Assuming Republicans do prevail in the Senate, Gwendolyn King said, immigration reform could be the most likely starting point for compromise. "That's an issue where both sides want to do something," she said. "Republicans recognize they are demographically challenged. We simply are losing the battle for voters, and have to bring more women and minorities into our ranks. How is that going to happen? Certainly not with the large Latino population in the United States—unless something is done on immigration.

"On the other hand," she continued, "there's a legitimate question of why should we (Republicans) do something on immigration reform if all those people come in under amnesty and get citizenship and then vote Democratic?"

That sort of calculus hints at what's been keeping Washington politics mired in gridlock for the past several years. The nation's capital today is a far cry from what it was in decades past, Colbert King said, and the key difference can be summed up in one word: polarization.

"Even during issues of civil rights, issues of war and peace, Washington still managed to engage in political battles without bringing the house down," he said. "Not today. Now the aim is not only to win but also to vanquish the competition—to grind your opponent into the ground. The biggest question today in Washington is not whether the Dodd-Frank Act is working or should be changed, it's not Ukraine or peace in the Middle East or raising the minimum wage or the Keystone pipeline. The question is whether Republicans can take control of the Senate and retain control of the House. [This issue] informs almost everything done in Washington these days, including the political behavior we see. Washington political strategists want to know only one thing: Will what we do mobilize or discourage our political base?"

Colbert King predicted that no overarching issues are likely to determine the outcome of the 2014 elections, but he did offer suggestions for the political parties. Democrats, he said, should not count too heavily on income inequality as a political rallying cry because it is hard to translate into a concrete message for voters. Democrats would be better off showing voters what they have done in the past to benefit them. And Republicans, he said, must find a way to be seen not as the party of obstructionism, but rather as one that has a positive message for the country. SVIA

Gwendolyn King is President of Podium Prose, a speakers bureau and speechwriting service, in Washington, DC. Prior to her launch of the company, Mrs. King was Senior Vice President of Corporate and Public Affairs for PECO Energy Company (formerly Philadelphia Electric Company) from 1992 until her retirement in February 1998. From 1989 to 1992, she served as the 11th Commissioner of the Social Security Administration under President George H. W. Bush. Mrs. King was appointed by President Ronald Reagan as Deputy Assistant and Director of Intergovernmental Affairs at the White House from 1986 to 1988. While there, she was appointed to the Advisory Commission on Intergovernmental Relations, the Interagency Committee on Women's Business Enterprise, and later, the Board for International Food and Agricultural Development. She was appointed by President Bill Clinton to the Commission on the Social Security Notch Issue, and by President George W. Bush to the Presidential Commission to Strengthen Social Security. Prior to her Presidential appointments, Mrs. King directed the Pennsylvania Governor's Washington, D.C. office for six years, following her service as senior legislative assistant to US Senator John Heinz (R-PA). Mrs. King was a Founding Partner of The Directors' Council. She is a director of Lockheed Martin Corporation and Monsanto Company, and ended 12 years of service on the board of Marsh and McLennan Companies in May 2011. She served for six years as director of the National Association of Corporate Directors, from 2004-2010. She is a trustee of the Barnes Foundation in Philadelphia, PA.

Colbert I. King is known for his provocative, insightful commentary in one of the world's most influential newspapers, the Washington Post. Colbert King is a Pulitzer Prize-winning journalist and an engaging speaker on a host of national, international and social issues. King is the former deputy editorial page editor of The Washington Post and also one of the newspaper's regular columnists. In his column, he brings a unique focus to the people whom are not among the powerful politicos of the nation's capital and often suffer from neglect and abuse. As the Post's editorial page editor, Fred Hiatt, said, "He writes about people who otherwise would get ignored, people who don't have much of a voice. He holds officials accountable. He shines a pretty powerful spotlight." He doesn't come from a conventional journalism background and, as a result, Colby King brings a varied perspective and expertise on many of the critical issues of the day.

Save the date: SVIA National Fall Forum, October 13-15, 2014 in Washington, DC

Outlook and Trends in Defined Contribution Plans

By Randy Myers

Stocks have been racing higher since 2009, attracting investor attention at the very time that low interest rates have been depressing fixed-income returns. Meanwhile, target-date funds have been attracting an ever-growing share of the money being saved in defined contribution plans, including money that once flowed into stable value funds. But a survey by asset manager PIMCO of the nation's leading DC-plan advisors suggests the outlook for stable value may be bright nonetheless.

To be sure, the industry faces challenges, said Stacy Schaus, executive vice president and head of defined contribution practice for PIMCO. Participant contributions to DC plans could continue to flow more rapidly into other investment options, she observed, particularly if plan sponsors become more aggressive about reenrolling employees into their plans and directing them into their default investment options. Consultants broadly support reenrollment, although relatively few plan sponsors have embraced it so far.

Stable value also could be threatened if Baby Boomers continue the current trend of rolling their DC-plan assets into Individual Retirement Accounts when they retire, since stable value funds are not available in IRAs. But, Schaus said, there are reasons to believe that plan sponsors and providers will find ways to make DC plans so attractive that participants won't want to leave them for IRAs.

PIMCO has surveyed retirement plan consultants annually for the past eight years. Its 2014 poll garnered responses from 49 leading consulting firms serving more than 7,800 clients—clients whose DC-plan assets totaled $2.8 trillion, or about half the DC marketplace. The survey found strong support among consultants for stable value funds. For example, every one of them said the core investment offerings in a DC plan should include a capital preservation option, which historically has meant either a stable value or money market fund. In addition, more than 70 percent said they were at least somewhat likely to recommend that clients replace their money market fund with a stable value fund if federal regulators follow through with their proposal to have net asset values for money market funds fluctuate with market values. All this, Schaus said, suggests the stable value industry has an opportunity to retain its place on the menu of core investment options in DC plans.

Nonetheless, she said, the stable value industry must find a way to have its products incorporated more broadly into target-date funds and other asset-allocation investment options, including managed accounts that have become the most popular default investment options in DC plans. Many managed account programs, as well as custom target-date funds created by larger plans, already utilize stable value funds, but off-the-shelf target-date funds generally do not.

"How well the industry weaves stable value into default (investment options) will largely determine where the future of stable value may go," Schaus said.

Here, too, the survey results were encouraging, with 39 percent of consultants actively promoting custom target-date strategies to their clients and another 43 percent supportive of client interest in the idea. (Figures for managed accounts weren't quite as strong. Still, 37 percent of consultants said they actively promote managed accounts or support client interest in them.)

Consultants like stable value in target-date funds in part because it can reduce the potential for losses without compromising returns—an especially important concern when participants are at or near retirement age. Consultants on average say participants should not be exposed to more than a 10 percent loss in their retirement account at age 65, Schaus said. Yet PIMCO looked at the 40

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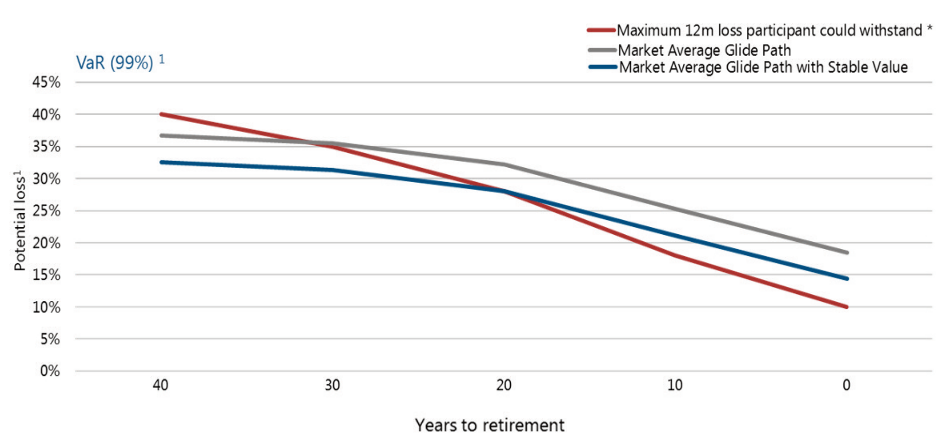
Case For Stable Value in Glide Path: Reduce Potential Loss



As of 31 MARCH 2014					
	VaR (99%)[1]				
Years to Retirement	**40**	**30**	**20**	**10**	**0**
Market Average Glide Path	36.8%	35.6%	32.4%	25.4%	18.5%
Market Average Glide Path with Stable Value	32.5%	31.3%	28.0%	21.0%	14.3%

* From 2014 PIMCO DC Consultant Survey
1 Value-at-Risk (VaR) is an estimate of the minimum expected loss at a desired level of significance over a 12m time horizon. Shown as positive percentage.The sample of risk factors is from January 1970 through the present date.

The Quest to Expand the Use—and Value—of Defined Contribution Plans

By Randy Myers

For employers worried about enrolling employees in their defined contribution retirement plans automatically at contribution levels that are too high, here's a counterintuitive finding: they should probably be worried about setting them too low.

Automatic enrollment effectively forces workers to save for retirement unless they make a conscious choice to opt out of their plan. It is widely credited with improving plan participation rates. Fidelity Investments has reported that among the more than 21,000 plans for which it provides recordkeeping services, auto-enroll plans enjoy participation rates of 84.3 percent of eligible workers, versus 68 percent for all of its plans. What's more, sponsors that automatically enroll participants at higher contribution rates tend to keep more participants in their plans than those with low contribution rates. Speaking at the SVIA's 2014 Spring Seminar, Elizabeth Heffernan, a vice president in the Fidelity Employer Services Center, said plans that set the automatic participant contribution rate at 3 percent of salary have average participation rates of 85.8 percent. Those that set the rate at 5 percent have average participation rates of 90.3 percent. Even at an automatic 6 percent deferral rate, 88.7 percent of eligible employees participate. "People are more committed at those higher savings rates," Heffernan observed.

Despite these telling figures, only a minority of plan sponsors have embraced automatic enrollment, and many continue to set deferral rates low. Among Fidelity plans, just 26 percent use auto enrollment. Those plans represent 59.6 percent of Fidelity's total participant base, however, indicating that auto enrollment is more popular among larger plans. Still, nearly 75 percent of all plans offering automatic enrollment set the base deferral rate at 3 percent of salary or less.

"Our default path is much too low," Heffernan said. "We need to get more plan sponsors comfortable with auto enrollment at 6 percent, at 7 percent, of salary."

Beyond boosting automatic deferral rates, Heffernan said plan sponsors could take several other measures to help employees achieve better results from their defined contribution plans, including adopting a policy of automatically boosting deferral rates on an annual basis. While 77.1 percent of Fidelity plans give participants the option to increase their deferral rates annually, only 12 percent increase them automatically.

In addition, Heffernan said, plan sponsors could boost plan participation by automatically enrolling not just new employees but also existing employees who aren't in the plan, a process known as reenrollment. "That's an area where we have a huge opportunity to do better as an industry," she said.

Some sponsors, Heffernan conceded, have embraced reenrollment not just to boost participation rates but also to automatically steer participants into more diversified investment portfolios. About 15 percent of participants in Fidelity-run plans have 100 percent of their assets in either stocks—generally considered the riskiest asset class available—or in the most conservative investment option, such as a stable value or money market fund. "There are not many situations where that is appropriate," she said.

Finally, Heffernan said, plan sponsors could help plan participants by offering products or services that assist them in converting retirement savings to income once they stop working. While most sponsors seem to have little appetite for offering guaranteed-income products, she said, they have shown interest in programs that would allow participants to take regular withdrawals from their accounts, and in guidance programs designed to help participants better understand their retirement-income options. SVIA

Outlook and Trends in Defined Contribution Plans

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largest target-date funds aimed at 65-year-olds and calculated the actual value at risk over a 12-month time horizon was closer to 20 percent. By contrast, a comparable fund that included an allocation to stable value put only about 10 percent of the participant's account value at risk.

Beyond expanding into target-date funds, Schaus said the stable value industry can help to solidify its future by convincing plan sponsors to educate plan participants to keep their money in their DC plans after retirement. Right now, she said, only a small minority of sponsors actively seek to retain those assets.

For retirees who do stay in their employers' retirement plans, Schaus said, the most important post-retirement need relating to that plan will be retirement income modeling and education, including one-on-one retirement counseling. The stable value industry can play a role in that, she said, by ensuring that the people and organizations creating retirement income models understand stable value and account for it properly in their models. SVIA

Save the date: SVIA National Fall Forum, October 13-15, 2014 in Washington, DC

Stable Value and Target-Date Funds: Experience and Opportunity

By Randy Myers

"Target-date funds are a freight train running down the tracks," said Brian Haendiges, senior vice president in charge of investment services for MassMutual Financial Group's Retirement Services Division, speaking at the 2014 SVIA Spring Seminar. "We're going to have to find the right way to interact with that phenomenon to stay in business."

Haendiges was part of a four-person panel that explored how target-date funds are being used today, and why, and how the stable value industry can make sure that it is part of the target-date revolution.

In 2012, Haendiges noted, target-date funds captured about 31 percent of all new contributions to 401(k) plans and already accounted for 14.4 percent of total 401(k) assets. By 2018, he estimated, target-date funds will be collecting two-thirds of all new contributions and will account for 35 percent of 401(k) assets. According to Fidelity Investments, he noted, about a third of plan participants have 100 percent of their plan assets in target-date funds—more than twice the percentage of five years ago. Among Generation Y participants—those born between 1979 and 1991—the proportion with 100 percent of their money allocated to target-date funds is even higher at 54 percent. Plan participants prize target-date funds, he observed, for their ease of use, diversification and professional management.

Still, Haendiges said, stable value remains a fundamental component of the 401(k) landscape, with its $700-billion plus in assets accounting for about 25 percent of total 401(k) assets at year-end 2012, according to the Aon Hewitt 401(k) Index. A key reason for stable value's continuing popularity, he said, is that investors have a high degree of risk aversion; they dislike losses more than they like gains, and stable value historically has delivered consistently positive returns with low volatility.

The goal for the stable value industry, Haendiges said, is to find ways to combine two popular investments—stable value and target-date funds—while preserving the favorable attributes of both. Doing that, he said, will require that the stable value industry build upon the recommendations and the approach that an unbiased and independent advisor would provide when looking at each participant and asset class individually.

Target-date weaknesses

Despite their popularity and positive attributes, target-date funds are not without problems. In 2008, in the depths of the credit crisis, funds with target dates between 2000 and 2010 lost an average 22.5 percent of their value, observed Glenn Jensen, managing director with New England Retirement Consultants. That meant a lot of target-date investors approaching retirement suffered big losses at a time when they could ill afford to do so. Compounding their pain, surveys found that about 80 percent of those investors thought they couldn't lose money in those funds.

To get better control of the risk embodied in their target-date funds, Jensen said, many larger plans are creating custom target-date funds from their own core investment options. Unlike off-the-shelf target-date funds that invest only in mutual funds, these custom funds can typically allocate money to stable value. Other benefits of creating custom funds, he said, include gaining flexibility in glide path construction, which can help reduce the volatility of investment returns prior to a plan participant's retirement date, and greater cost efficiencies. Also, while the vendor of an off-the-shelf target-date fund typically does not accept ERISA fiduciary responsibility, he said, plans creating custom funds can engage a registered investment advisor to act as a co-fiduciary to the plan.

Making stable value work with target-date funds

Gary Ward, vice president, institutional stable value for Prudential Financial, said that in its stable-value wrap contract business, Prudential divides the risks associated with target-date products into two buckets. One is simply ongoing product or market risk. The other is what he calls concentrated decision-maker or event risk: the risk that some plan event, such as a reenrollment of plan participants or the introduction of a new asset-allocation product, could result in a lot of money moving from stand-alone funds, including the stable value fund, to an asset allocation product in a very short period of time.

Nick Gage, senior director with Galliard Capital Management, said more than half of his firm's 100-plus stable value separate-account clients—most of them larger defined contribution plans—already offer a professionally managed product or service, such as a suite of target-date funds or managed accounts, that allocates money to stable value. When implementing or changing one of these products, he said, Galliard will advise the client on the potential impact on stable value investors, obtain approval from the stable value contract issuers and make any required contract amendments, modify the investment or liquidity management strategy for the stable value portfolio as needed, and monitor the impact on cash flows into and out of the stable value fund.

"A lot of our clients really like their stable value option and the value it provides to their participants," he said. "But they are concerned that their participants aren't making the best investment choices and won't be prepared for retirement. We need to work together with them to make sure they can continue to offer the stable value product they want to offer their plan participants, while also doing what they feel is their duty as a plan sponsor to prepare their employees for retirement."

More than just target-date "funds"

Both Haendiges and Ward encouraged their colleagues to think about target-date products more broadly than just target-date funds. Almost any product or service that drives asset-allocation decisions, from recommendation services to automatic advice engines to managed accounts, can have an impact on how and where stable value products are used, Ward said. Accordingly, they all represent both an opportunity, and a risk-management challenge, for the stable value industry.

"There's far more work we can do to find different ways to get stable value in asset allocation funds," Ward concluded. SVIA

Expanding Stable Value's Reach

By Randy Myers

It's time for the stable value industry to think outside the 401(k) box.

While the vast majority of stable value assets are held in 401(k) plans, the benefits of stable value funds are too great to be limited to that sector of the marketplace, according to a panel of stable value executives who spoke at the 2014 SVIA Spring Seminar.

The 403(b) market

Stable value funds are already found in various types of defined contribution retirement plans: 401(k), 401(a), 403(b) and 457 plans. The 403(b) market, which caters to tax-exempt organizations such as schools, hospitals and religious groups, is a particularly ripe opportunity for the stable value industry, said Robin Andrus, marketing director at Prudential Financial. From the fourth quarter of 2012 to the fourth quarter of 2013 assets in 403(b) plans grew by 7 percent and the number of participants in those plans grew by 6 percent. Regulatory changes and the trend away from defined benefit retirement plans to defined contribution plans will translate to growth in this market for at least the next few years, she opined. One challenge: federal regulations generally prohibit 403(b) plans from using collective, or pooled funds, which means plans will have to be large enough to make a separate account product economically viable for both them and stable value providers.

Andrus also encouraged her industry colleagues to look for opportunities within the K-12 sector of the education market. And, she said, investment-only asset managers may wish to consider offering stable value funds through other providers' open architecture platforms in the healthcare and higher education segments of the retirement plan market.

529 plans

LeAnn Bickel, head of stable value contract administration for Invesco Advisers, said the 529 college savings plan market also offers opportunities for stable value providers to broaden their client list. Her firm already provides stable value products for three 529 plans offered by the states of Virginia and West Virginia, which have combined plan assets in excess of $6 billion and stable value assets of nearly $900 million.

Stable value makes sense for 529 plans, Bickel argued, because participants in those plans need an investment option that provides safety of principal, especially during the beneficiary's later years of high school and college; competitive returns, especially in light of current market conditions; and liquidity for qualified withdrawals at book value. Stable value offers all of that.

For stable value providers, Bickel said, the 529 market has attractive underwriting characteristics relative to the 401(k) market, including generally smaller account sizes, more stable and certain cash flows, less transferring of assets from one investment option to another, and a smaller incidence of participants rolling money into a competing account. She also noted that plan sponsors and their program managers are very willing to provide the data needed by stable value wrap issuers to underwrite funds for them.

Assets in 529 plans grew by $36.4 billion in 2013 to a record $227 billion, Bickel said, with $22 billion of that growth attributable to contributions by plan participants. The average account size grew to a record high $19,584, a 14 percent increase. Behind the growth: the ever-leaping cost of college tuition, which has been increasing about 8 percent annually. Tuition for a public four-year institution now averages $18,391 per year, Bickel said, and parents and grandparents are eager to capitalize on the tax advantages that saving for higher education in a 529 plan offers.

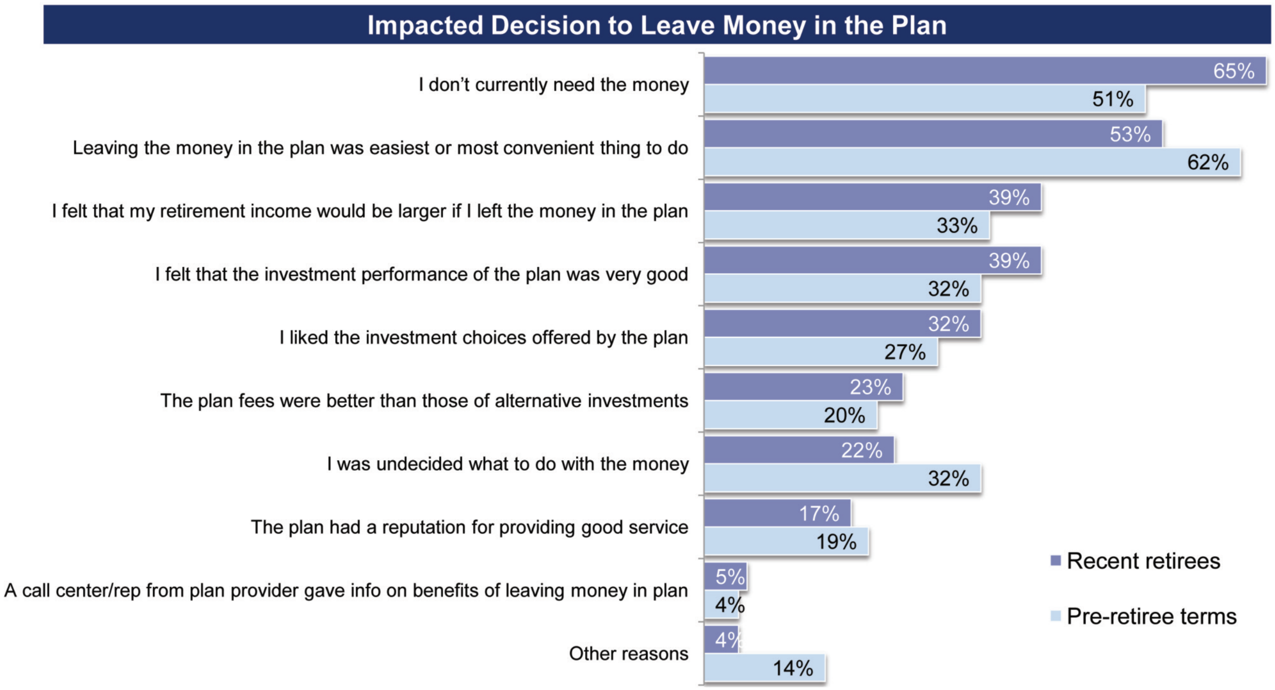
Unfortunately, she said, some may not be getting the best value. Many 529 plans continue to use money market funds as their low-risk investment option, and while money market funds share the low volatility characteristic of stable value funds, their returns have historically lagged behind those available from stable value.

One of the challenges the stable value industry faces in trying to penetrate the 529 market more deeply, Bickel said, is simply finding enough wrap issuers who are familiar with and interested in it. It's not that they are overly concerned about the risks, she said, but rather that they think of it as a new product with all the attendant startup demands. Also, 529 plans cannot use commingled funds, so the plans need to be of sufficient size to make it economical to offer a separate account product. Nonetheless, Bickel said, "we see this as a growth area."

"Hybrid" funds

Some stable value opportunities lie not in broadening the industry's reach into other types of savings plans, but in delivering a diverse range of stable value options, including so-called "hybrid" stable value funds. That's a term that Brett Gorman, a senior vice president in the defined contribution practice at asset manager PIMCO, says he doesn't like, but it nonetheless seems to have gained traction. Gorman said the term can refer to an otherwise standard stable value fund that allocates an unusually high percentage of its assets to a short-term investment fund (STIF), allocates some portion of its assets to bonds that are not covered by a stable value wrap contract, or both. In either case, the structure would call for the alternative holdings—the STIF or the unwrapped bonds—to be accessed for withdrawals alongside of, or even before, the fund's wrapped bonds.

Gorman said his firm continues to believe that a true stable value fund is a better capital-preservation solution for plan sponsors that are comfortable with the associated risks and the requirements of the product's wrap contracts. Still, he conceded that hybrid structures, while not common, have been around a long time, and that there may be instances where a hybrid approach makes sense. Perhaps the sponsor has demographic or cash-flow challenges that would make it difficult to offer a stable value fund, he said. Maybe it is engaged in a lot of merger-and-acquisition activity or divestitures, or from a legal perspective just isn't comfortable with the terms of wrap contracts. "Whatever the reason, there is a growing preference for customization and white-labeling by both consultants and especially larger plan sponsors for the options in their funds," Gorman said. "This may mean we as an industry



Note: Multiple responses allowed.

start to see more opportunities to engage with sponsors on these types of structures."

Stable value providers should consider several factors when deciding whether to offer hybrids, Gorman added. "The first is what type of investment risk, and therefore volatility, is acceptable in the unwrapped portion of the fund, if there is one? Second, do underwriting standards need to change? For instance, how are plan design features such as competing options or advice or structural mitigants that we might have, such as equity washes, viewed by the wrap issuers? Next—and I think we're all agreed that calling such product stable value is not appropriate—is what to call the option. Also, how is the investment structure communicated to participants? That's really key. Finally and perhaps most importantly, are there reputational risks to traditional stable value products associated with offering these hybrids?"

With interest rates low and at the end of a 30-year bull market, Gorman also observed that any firm launching a hybrid structure now won't have as much carry to offset the fund's mark-to-market volatility as has been common in the past, suggesting a higher probability of daily, monthly or quarterly negative returns. In that case, he said, it's not unreasonable to consider whether there is a potential for higher rates of withdrawals from such a product.

Although still a proponent of traditional stable value products, Gorman said he recognizes that hybrids offer some benefits for retirement plan sponsors, plan participants and even the stable value industry. For participants, he said, even a hybrid fund will offer some of the attractive benefits of book-value accounting. For plan sponsors, a hybrid structure should have slightly lower fees than a pure stable value product, and provide yet another option for their investment menus. For wrap issuers, having more assets available for withdrawal ahead of the stable value contract should be comforting. Finally, for the stable value industry, having plan sponsors who aren't comfortable with a traditional stable value fund opt for a hybrid would at least mean that more sponsors overall are using, and are committed to, the benefits of book-value accounting. "More plan sponsors than fewer vested in the ongoing success of benefit-responsive contracts is generally a very good thing for all of us," he said.

Stable value and "de-accumulation"

Perhaps the most obvious strategy for boosting stable value assets is to hold onto the business you already have. Anthony Camp, vice president of the Stable Value Product Group at ING U.S. (which will become Voya Financial in 2014), noted that the first wave of the nation's approximately 78 million Baby Boomers reached age 65 three years ago, and that the Boomers have accumulated significant assets in defined contribution and individual retirement accounts (IRAs). At the end of 2013, he said, assets in defined contribution plans totaled $5.9 trillion, and in IRAs $6.5 trillion.

Unfortunately, Camp noted, many investors roll their money out of their defined contribution plan and into an IRA when they stop working—about 43 percent did so in 2012, according to the LIMRA Secure Retirement Institute. And stable value funds are not available to IRA investors. To the extent the stable value industry can help convince more participants to stay in their defined contribution plans—as 41 percent did in 2012—more retirees will have a chance to continue reaping the benefits that stable value funds offer.

"I think this is a huge opportunity," Camp said. So too, he said, would be exploring the possibility of again getting regulatory approval to offer stable value funds in mutual-fund format to IRA investors. "It sticks out as a large opportunity," Camp said. "Maybe not enough time has gone by, but if we were looking for ways to expand stable value outside traditional defined-contribution plans, this sticks out to me."

New Wrap Capacity Offers More Opportunity for Growth … and Competition

By Randy Myers

The stable value industry has a new focus on growth.

In the aftermath of the 2008 credit crisis, a number of stable value wrap issuers exited the business, constraining the industry's ability to grow. But over the past few years new issuers have entered the market, and veteran players have increased their appetite for new business. The result is that the industry has $87.75 billion in new wrap capacity available for 2014, according to a survey conducted by the Stable Value Investment Association. And that could eventually have an impact not only on the industry's growth but also wrap issuers' fees and contract terms.

Speaking at the SVIA's 2014 Spring Seminar, Marijn Smit, president of Transamerica Stable Value Solutions, said 25 issuers were surveyed in March 2014, with 23 responding. They included 22 current issuers and one potential entrant to the market. The 22 current issuers reported $544 billion in product balances at year-end 2013, up from $443 billion among 20 survey respondents the prior year, and $424 billion from 18 respondents two years earlier.

Of the business already on the books at the end of last year, 55 percent represented synthetic GICs, 23 percent separate account GICs, 20 percent general account GICs and 2 percent traditional GICs. New capacity is similarly aligned: 58.1 percent is available for synthetic GICs and another 13.4 percent for commingled synthetic GICs, 18.2 percent for separate account GICs, 8.3 percent for general account GICs, 1.7 percent for traditional GICs and 0.3 percent for commingled GICs.

As part of the survey, issuers were asked what might inhibit their appetite for business in 2014. For both pooled fund and separate account/single fund business, the biggest concern, cited by about three-quarters of the respondents, was the presence of competing funds in a retirement plan that had no equity wash provision to minimize interest-rate arbitrage. In the case of pooled funds, the other top issues were duration limits greater than three years on underlying investments (cited by 52 percent of respondents) and market value/book value ratios for a stable value fund below par (48 percent). For separate accounts and single funds, below-par market-to-book ratios also were a top concern (39 percent of survey respondents), but duration limits were less worrisome, cited by only 13 percent of respondents.

Competitive pressures?

The availability of new capacity doesn't mean that it will all be used, observed Smit, who participated in a panel discussion of the survey findings with other wrap issuers. In 2013, he noted, issuers had indicated $103.5 billion in new capacity available and only used $48.76 billion of it. In 2012 they offered $77.5 billion in new capacity and used $26.98 billion.

"This could mean that we have capacity chasing a more limited opportunity set, which could translate into competitive pressures," Smit said. But he quickly discouraged any notion that issuers should become too lax in their investment guidelines or pricing standards. "At Transamerica, we believe the risk-return profile from an issuer perspective is appropriate the way it stands, and we don't think the industry would be well-served by a renewed race to the bottom," he said.

Jessica Mohan, managing director with Bank of Tokyo-Mitsubishi UFI Ltd., offered similar sentiments. "One of the things we learned from 2008 was that the viability of this product is inextricably tied to wrap capacity," Mohan said. "The market can't grow unless there is capacity available. Now, we see there's plenty. I think that's a result of the hard work done by investment managers partnering with their service providers for more conservative investment guidelines and more consistency across contract terms."

Tom Schuster, vice president of stable value management for Metropolitan Life Insurance Co., conceded that stable value investment guidelines had become too broad and wrap fees too low prior to the credit crisis. He said the industry is now in a much better position. But he also said that while wrap issuers need appropriate pay and protection for the risks they are taking, investment managers need investment guidelines that allow them to enhance the performance of their funds. "Ultimately," he said, "we need to deliver a product that is attractive to plan participants."

MetLife wraps more than 20 subadvisors in a little more than 50 manager mandate combinations, Schuster said. Immediately after the credit crisis, he said, the company probably didn't differentiate as much as it should have, based on manager capabilities and competencies, when negotiating investment guidelines. But he added that over the last 18 to 24 months MetLife has been willing to wrap investment guidelines that are more tailored to the manager's capabilities, which he thinks enhances his firm's risk profile. "The goal is to allow the manager to perform based on capabilities where they demonstrate strength," he said. "And if they are able to demonstrate that capability then they should be given more flexibility."

"I would echo that," added Frederick Ramos, senior managing director with State Street Bank & Trust Co., saying that if an investment manager sees an opportunity that falls a little outside its investment guidelines but is in line with its expertise and capabilities, State Street is happy to discuss it.

For all the progress that's been made in tightening investment guidelines, and in standardizing contract terms for stable value funds with multiple wrap providers, the consensus of the panel seemed to be that establishing the right guidelines and contract terms will remain an ongoing exercise.

"While (the industry is) trying to be generous with the guidelines and find that middle ground where they are wide enough for managers to add value but tight enough so that the cost of doing business is not prohibitive, there is a dynamic that is still playing out," said Marc Magnoli, executive director of AIG.

Stable Value Managers See More Flexibility on Investment Guidelines

By Randy Myers

The trend toward ever-tighter stable value investment guidelines appears to be ending.

Following the 2008 financial crisis, issuers of stable value wrap contracts began tightening investment guidelines for stable value managers, typically requiring new limits on the duration and credit quality of the assets held in their stable value funds. In some cases, managers worried that those limits were being applied too broadly, without taking into account their experience and expertise or the unique characteristics of the retirement plans in which their funds were being offered. Now, the pendulum that some thought may have swung too far appears to have reached its zenith. No one is suggesting that investment guidelines are becoming as loose as they were prior to the crisis, but investment managers say wrap issuers are becoming slightly more flexible in their demands.

"Before 2008 guidelines were very broad," said Sean Banai, senior vice president, portfolio management for ING U.S., at the 2014 SVIA Spring Seminar. (ING U.S. will become Voya Financial in 2014.) "Afterward, guidelines became like books; we'd see guidelines that were 10 to 15 pages long and very restrictive. But what we've seen recently is that wrap providers are becoming more flexible and are willing to talk about some of their guideline limitations, especially for separate accounts where we can work with some of the underwriters and figure out a more customized guideline for each plan. We have seen some flexibility in structured allocations and in spread duration limits, and overall that has been good."

"I'd agree with Sean. We're seeing more flexibility come back," said Erik Karpinski, vice president with GSAM Stable Value LLC, who joined Banai in a panel discussion on a wide range of issues facing stable value managers. "I think it's really important for all of us given the historically favorable spread of stable value returns over money market returns. In the current environment, where fixed-income yields are low, we need to remain cognizant of that and see where we can add value."

The panel also discussed the impact that bundled stable value products from insurance companies are having on investment management trends and stable value expense ratios, the impact on stable value funds when plan sponsors decide to reenroll plan participants into their retirement plans, and strategies for dealing with any potential rise in interest rates.

Bundled products

In the wake of the financial crisis, insurance companies increasingly began offering "bundled" wrap coverage for stable value funds, meaning they required that some or all of the assets covered by their guarantees had to be managed by their own affiliates. One consequence for a number of stable value managers, said Steve LeLaurin, managing director, stable value wrap strategy for Invesco Advisors Inc., is that some funds wound up using more subadvisors than they had in the past. While that may have added some incremental cost to those funds, he said, it also will help smooth performance over time by introducing greater diversity of management styles. And that, he said, "is a good thing."

Re-enrollments

Retirement plan sponsors reenroll employees in their plans for a number of reasons, including a change in plan providers or a desire to steer more employees into their plan's qualified default investment alternative, which is often a target-date fund. In either case, reenrollment can result in assets flowing out of stable value funds and into those default options. Susan Graef, a principal with Vanguard Group, said it has been her firm's experience that about 70 percent of the assets in stable value funds are directed into other investment options in reenrollments. And LeLaurin observed that it isn't uncommon to see as much as 75 to 80 percent of stable value assets reallocated to other products.

The idea of reenrolling specifically to steer participants into default investment options "is probably the biggest thing we all have to think about," Karpinski said, given that it results in substantial cash flows out of stable value funds. That's not a terribly difficult issue to manage at the moment, when the market value of most funds exceeds book value, but it could become more challenging when market-to-book ratios fall below 100 percent. To mitigate that issue, Karpinski suggested, the stable value industry should explore mounting a new push to have stable value classified as a qualified default investment alternative, since that would probably reduce the outflow of cash from stable value funds during reenrollments.

LeLaurin observed that plan sponsors are taking varying approaches to dealing with the capital gains in their stable value funds during reenrollments. Some are distributing those gains to participants, others are leaving the gains in the stable value fund for the benefit of those participants who remain in the fund. He also noted that some plan sponsors have inquired about whether now might be a good time to discontinue offering their stable value fund because market-to-book ratios are high. Almost all of Invesco's clients have been persuaded that doing so wouldn't make much sense, he said, especially since yields on the most common alternative, money market funds, are still near 0 percent.

Preparing for rising interest rates

Rising interest rates depress prices for fixed-income assets, a concern for stable value managers who invest almost exclusively in fixed-income securities. With interest rates widely viewed as being at the tail-end of a 30-year bull market, and the Federal Reserve winding down a quantitative easing program that was aimed at keeping rates low, stable value managers have been preparing for the day when rates start to rise again. Banai said his firm has convinced some clients to reduce the duration of their fund's investment portfolio over the past 12 to 18 months, since shorter-duration assets aren't impacted as much by rising rates. In some of its portfolios, ING also has increased allocations to structured products, including short-term commercial mortgage-backed securities and commercial mortgage obligations.

Garth Talbert, senior fund manager for ICMA Retirement Corp., said his firm has taken similar measures, but not aggressively since it wants to preserve as much yield as possi-

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A Predictable Surprise

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about $35 trillion to be kept alive that long on a pay-as-you-go basis.

Of course, even as the Social Security system was weakening, the private retirement system was changing too. Increasingly unwilling or unable to support defined benefit pension programs, employers in the 1990s began phasing them out in favor of defined contribution plans funded to a large degree by employees rather than employers. By 2011 there were 16.5 million active participants in defined benefit plans, Schieber said, down from 30.1 million in 1984.

All this has meant is that Americans today must devote a far higher percentage of their income to retirement savings than they did in the past if they want to be financially secure after they stop working. Why might you ask? When Social Security was designed, most workers life spans did not extend to Social Security's eligible retirement age, which made it highly unlikely that the majority of workers would collect Social Security benefits. Today, the Social Security Administration estimates that today's retirees, those who have reached age 65 starting in 1990 will receive Social Security benefits for a little more than 15 years if male and almost 20 years if female.

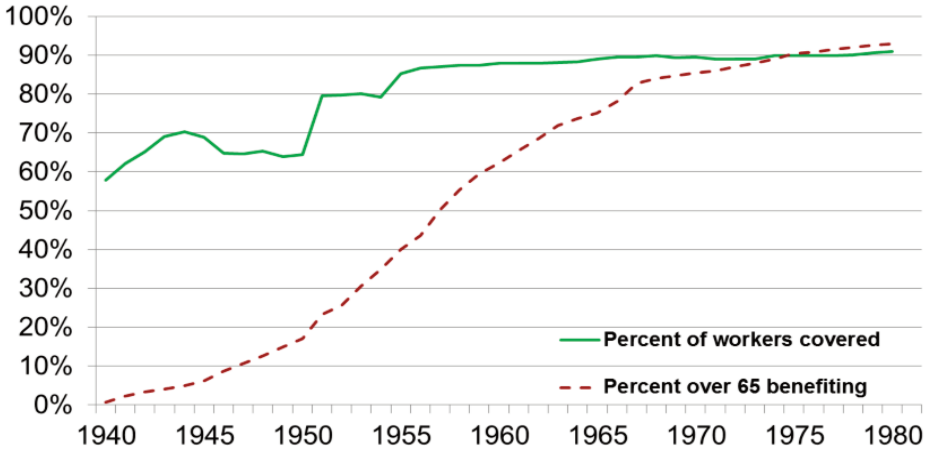
In 1955, Schieber calculates, workers had to contribute 2.1% of their earnings via payroll taxes to fund Social Security, and save another 4.6% on their own—a total of 6.7% of their income—to support themselves in retirement. Today, he estimates, they must contribute 15.3% in the form of payroll taxes (half provided by employers) and save another 7.5% on their own, for a total of 22.8%. By 2035, he projects the equivalent numbers will be 19.9% and 8.5%, for a total of 28.4% of lifetime earnings. "This is why financing our retirement system today seems so much harder than it did when I was starting in business," Schieber said.

There is good news on the retirement income front, Schieber said, today's retirees are in better shape than popularly cited statistics would suggest. The official yardstick of economic status in the U.S. is based on the Census Bureau's Current Population Survey (CPS), which is used to analyze the potential impact of policy decisions in Washington. Schieber contends that the CPS doesn't fully capture the income received by retirees. In 2008, for example, the survey showed that people receiving Social Security benefits also received $5.6 billion in IRA distributions and $222.2 billion in pension and annuity income. But those same people, on their federal tax returns, reported receiving $110.9 billion in IRA distributions—excluding income from Roth IRAs—and reported another $457.3 billion from pensions and annuities.

Still, Schieber concluded, it's important that the country take steps to improve both its public and private retirement systems. In addition to strengthening Social Security, he said, individuals will have to rethink the work/retirement cutoff point and perhaps stay in the workforce longer.

"The system is out of balance," he concluded. "We have to do something to get it rebalanced, and the sooner we can the better we will be. We have to be extremely careful not to delay this until the only way we can deal with this issue is by levying taxes on the next generation—because they're going to face exactly the same thing we're facing. It's not clear their real incomes are going to be any bigger than ours. All we're talking about is passing along a substantial burden that we've not been willing to pay ourselves." SVIA

Percent of Workers Covered by Social Security and Percent of Persons Aged 65 and Over Receiving Social Security Benefits



Stable Value Managers

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ble for plan participants within the constraints of its investment guidelines. He noted that Wall Street has been worrying about rising rates since the Fed cut its target for the federal funds rates to between 0 percent and 0.25 percent in December 2008, but that anyone who took extremely defensive positions at that point would have given up substantial returns since rates, especially at the shorter end of the yield curve, have generally remained low. "We try not to be too tactical with this," Talbert said. "That's why you have (wrap) insurance, to really absorb those kinds of market changes that go on over time."

Graef said it is critical that stable value managers educate plan sponsors and plan participants about the potential impact of rising rates, not only on their stable value funds but on other investments that may do poorly in a rising-rate environment. LeLaurin added that Invesco reminds sponsors that rising rates can be good for participants in stable value funds in the long run, because over time it will boost the yield on fund assets and hence the fund's crediting rate. SVIA