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Retirement through the Generations

By Randy Myers

Americans’ expectations about when they will retire, and how they will pay for it, vary significantly depending upon their age, according to new research from the Transamerica Center for Retirement Studies.

The center polled more than 4,500 working Americans in early 2015 for its 16th Annual Transamerica Retirement Survey of Workers. To compare their views and practices, the center segmented those polled into five age groups: those in their 20s, 30s, 40s, 50s, and 60 and older.

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Legal Update – Plaintiffs’ Bar Updates New Theory

By Randy Myers



Financial services firms that cater to the retirement plan market might be excused for thinking there’s a target on their back.

As attorneys from the law firm of Morgan, Lewis & Bockius explained at the 2016 SVIA Spring Seminar, the ERISA plaintiffs’ bar continues to test new theories about ways that service providers, and plan sponsors, have allegedly breached their duties to retirement plan participants.

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Stable Value Trends and Opportunities

By Randy Myers

They’ve been a staple of defined contribution retirement plans for more than four decades, but stable value funds still have room to grow.

Speaking at the 2016 SVIA Spring Seminar, executives from investment advisor Callan Associates noted that stable value funds continue to be used by more than 60 percent of the 100-plus large defined contributions tracked by their firm’s Callan DC Index. In fact, that percentage has actually been climbing modestly over the past three years. However, James Veneruso, vice president and defined contribution consultant in Callan’s Fund Sponsor Consulting Group, also showed a graphic indicating that stable value has been accounting for a gradually shrinking share of the total assets in those plans. And since 2005, Callan’s data shows, the crediting rates paid out by stable value funds have outperformed the Barclays U.S. Aggregate Bond Index, providing stable value with a compelling risk-reward tradeoff.

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Retirement through the Generations

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The survey found that the older workers are, the more likely they are saving for retirement. Among workers in their 60s, more than four in five—81 percent—are stockpiling money for the day they retire. By contrast, only 67 percent of those in their 20s are saving for retirement.

More diligent saving doesn't necessarily translate into expectations of an earlier retirement, however. Only 18 percent of those in the 60-and-older crowd expect to retire at or before the age of 65. By contrast, 57 percent of those in their 20s expect to retire by age 65.

A skeptical observer might detect some overconfidence on the part of the younger generation. But Catherine Collinson, president of the Transamerica Institute and the Transamerica Center for Retirement Studies, says survey data overall indicate that 20-somethings are more appropriately characterized as “committed, cautious and concerned.”

Collinson presented the findings of the survey at the 2016 SVIA Spring Seminar. Looking more closely at the 20-somethings category, she said 37 percent concede they know nothing about basic asset allocation principles. A quarter of them are invested in low-risk, low-return investments that may be too conservative given their long investment horizon. About four-in-five (81 percent) are concerned that Social Security will not be there for them when they get ready to retire. That isn't irrational, Collinson said, given that the Social Security Administration's 2015 annual report projects that the Social Security trust funds will be depleted by 2034, well before most of today's 20-somethings will retire.

The survey found that 76 percent of 30-somethings are saving for retirement. Among those participating in a 401(k) or similar workplace retirement plan, 30 percent are contributing more than 10 percent of their salary. Collinson called workers in this age group strong savers, but weak planners. Although 87 percent say they prefer to make their own decisions about their retirement investments, 57 percent concede they guess at their retirement savings needs, and 68 percent say they don't know as much as they should about retirement investing.

Collinson said she worries most about those in their 40s, who make up “the critical mass” of Generation X. “They were hit really hard by the Great Recession, and 27 percent have not yet begun to recover from it or feel they may never recover,” she said. “Only 10 percent are very confident they will be able to fully retire with a comfortable lifestyle.”

Collinson called 40-somethings “financially frazzled but focused.” While 76 percent are saving for retirement, 22 percent list paying off credit card or consumer debt as their greatest financial priority. Nearly a quarter of those participating in a 401(k) or similar plan have taken a loan or early withdrawal from it. Some 40-somethings are already in life's “sandwich years,” too, Collinson noted, meaning they're taking care of both younger and older generations, often before taking care of themselves.

“All these factors are making things even more difficult for 40-somethings,” Collinson said. “As an industry, the most important thing we can do is start with a vote of confidence. [We can tell them] you've still got 20 years—a couple of decades—to plan and save and get back on track. You still have time to change your retirement outcome. However, you can't afford to wait any longer.” Procrastination, she said, is the enemy of 40-somethings.

Fifty-somethings can see retirement on the horizon and are actively planning for it. Eighty percent are saving for retirement, and 37 percent say it is their top financial priority. Still, Collinson said, there is reason for 50-somethings to be concerned about their prospects. The median household in this age group has only \$117,000 in savings, which for many will not prove sufficient to support a retirement that could last 20 or 30 years. Indeed, 42 percent of those in their 50s say they expect their standard of living to decrease when they retire, and 59 percent say they plan to work past the age of 65—or not retire at all.

“Working longer is a logical practical solution, but life can get in the way,” Collinson cautioned. She said it's important for workers in this age group to take a hard look at their savings and income

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needs, develop a pre and post-retirement strategy for managing their financial needs, create a backup plan in case health or some other event causes an earlier than expected retirement, and work with a financial planner.

What about 60-somethings, the age group for whom retirement is just around the bend? “Baby boomers have rewritten the rules at every stage of life, and retirement is no different,” Collinson said. A stunning 82 percent of 60-somethings expect to work past age 65 or already are doing so, or do not plan to retire at all. More than half (52 percent) plan to work at least part-time in retirement, easing into a phased retirement in which they pursue work that is either more satisfying or less demanding, or both. One possible problem with that scenario, Collinson said, is that while 73 percent of 60-somethings think this transition will take place at their current employer, very few employers actually have practices in place to

facilitate any sort of phased retirement.

“This is a huge societal opportunity,” Collinson said. She added that the retirement industry could help by working with employers to create phased retirement programs.

Employers can help American workers better prepare for retirement, she concluded, by encouraging participation in existing retirement plans, structuring matching contribution formulas to promote higher salary deferrals, and discouraging loans and withdrawals from retirement accounts. Collinson also encouraged employers to offer retirement education offerings that are easy to understand and help pre-retirees plan their transition into retirement. Employers also can promote incentives to save such as the Saver’s Credit and catch-up contributions. She also urged retirement plan sponsors to extend eligibility for their plans to part-time workers. **SVIA**

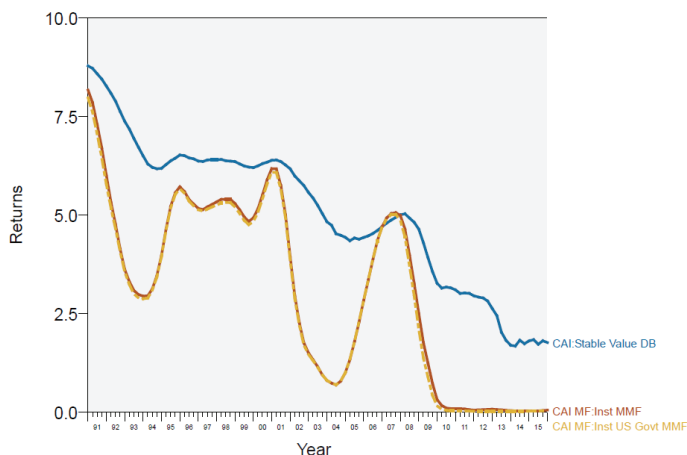
Stable Value Trends and Opportunities

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Callan contends, though, that stable value funds continue to offer a material advantage over their most common competitor, money market funds. Over the past 25 years, Veneruso noted that stable value funds have generated higher returns than money market funds for all but one brief period of time before the 2008 financial crisis.

Upcoming rule changes for money market funds also seem likely to impact stable value funds and their appeal to plan sponsors. Beginning in October, the Securities and Exchange Commission will require institutional prime money market funds to let their net asset values float with their underlying market value. Prime funds also will be required to impose redemption fees and gates during periods of illiquidity in their portfolios.

Rolling 4 Quarter Returns
for 25 Years Ended December 31, 2015



Callan has taken the performance of stable value funds relative to money market funds into account when helping plan sponsor clients choose investment options for their retirement plans, and in designing—and in some cases managing—their custom target-date funds. The company’s Callan GlidePath Funds are custom target-date funds that use an open architecture approach. As such, they allow the use of best-in-class investment managers, and a transparent, low-cost, institutional fee structure. Callan uses a stable value fund as the principal preservation component of its Callan GlidePath Funds, with

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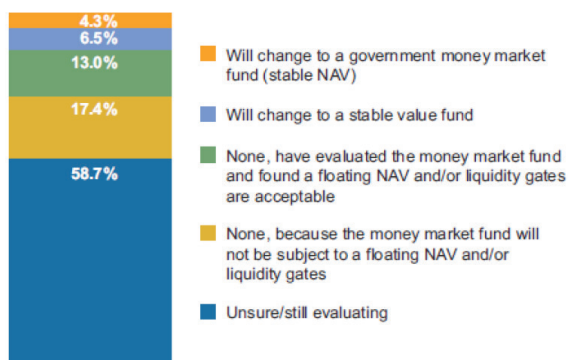
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allocations to stable value ranging from 3 percent of assets in funds with a target date of 2020 to 15 percent of assets in those with a target date of 2005.

J.J. Milder, senior vice president in Callan's Trust Advisory Group, said the Callan GlidePath Funds hold about \$29 billion in stable value assets, which in turn are backed by a dozen contract issuers.

Callan also oversees stable value funds structured as separate accounts for individual plan sponsors. Investment objectives, returns and portfolio characteristics can vary slightly from one fund to another. For example, Milder said, the stable



value fund in its GlidePath funds recently had an underlying duration of 2.5 years, an expense ratio of 42 basis points, and a crediting rate of 1.60 percent after fees. By contrast, a separate account stable value fund it manages, and which seeks to generate a stable income stream comparable to the returns available from short-term U.S. fixed income securities, had an average duration of 2.9 years, an expense ratio of 37 basis points, and a net annualized crediting rate of 1.98 percent.

Milder said her firm sees three principal opportunities for stable value funds to attract more business in the years ahead. The first relates to the so-called "DB-ization" of defined contribution plans, in which DC plans try to borrow some of the best ideas from defined benefit plans. This would include the use of open architecture investment platforms using institutional managers and vehicles, including stable value funds, rather

than mutual funds. In its latest survey of large DC plans, Callan found that 71 percent were using collective investment trusts as investment options, versus 52 percent as recently as 2013.

Stable value also could benefit from the growth and "institutionalization" of custom target-date funds, which unlike mutual funds can include a stable value component, Milder said. She noted that only 32 percent of surveyed DC plans are using their record-keeper's proprietary target-date funds today, down from 70 percent in 2011.

Veneruso added that there also are opportunities for stable value funds as a standalone investment option for DC plan participants who are near retirement, perhaps as a retirement income solution.

"The retirement income solution is currently being described by a lot of managers as the Holy Grail," Veneruso said. "How do you perform this alchemy of taking a pool of assets someone has accumulated and turn that into something they can live off of in retirement? Whether it's a guaranteed product, whether it's a non-guaranteed draw-down product, there is a lot of innovation going on there, and that's another area where we see a lot of opportunities."

It will be important for the stable value industry to capitalize on these opportunities. Although the use of stable value funds within defined contribution plans has held fairly steady, it tends to be older participants—those between the ages of 50 and 65—who are making the most use of the asset class. The question, Veneruso said, is what will happen to those assets once those participants segue into retirement? In other words, will the share of assets in stable value funds continue to shrink relative to target-date funds. "As an asset manager, that's something to consider," he said. "And it's why target-date funds can represent an opportunity for stable value managers." **SVIA**

Legal Update – Plaintiffs’ Bar Updates New Theory

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The cases generally fall into three categories, said Morgan Lewis partner Melissa Hill:

- Lawsuits against providers of stable value funds alleging they did not prudently manage the stable value option.
- Lawsuits against insurance companies that service retirement plans or provide guaranteed benefit options.
- Lawsuits against plan sponsors and fiduciaries alleging that they breached their fiduciary duties by offering retirement plan participants a money market fund rather than a stable value fund.

The cases against stable value providers, and in many cases plan sponsors, are particularly frustrating because the allegations keep shifting. “They used to claim that you were too risky and too aggressive, and therefore there were some losses,” Hill observed. “Now the claim is that you are too conservative and you didn’t achieve the returns we expected. It’s what I call Goldilocks litigation: either it’s too risky or too conservative; never just right.”

In one recent case, Hill said, the plaintiffs allege that Fidelity Management Trust Co., among other things, used an “unduly conservative” investment strategy for the stable value fund offered in the 401(k) plan of bookseller Barnes & Noble. The suit charges that Fidelity made the fund more conservative after the 2008 financial crisis to appease the fund’s wrap providers, at the expense of plan participants. Fidelity filed a motion to dismiss the suit. However, the federal district court judge ruled against Fidelity’s motion to dismiss, which permits the suit to go forward. In a similar lawsuit against Union Bond & Trust Co., Hill said, a court has already dismissed claims of excessive fees, but has allowed claims of imprudent management to proceed.

Hill pointed out that the allegations in the Fidelity case are “exactly the opposite” of those made in an earlier case against JPMorgan Chase. Similarly confounding, she said, is that both cases have employed the testimony of the same expert plaintiffs’ witness.

The implication, Hill said, is that the insurers

simply decided how much they wanted to earn and set their crediting rates accordingly. “You scratch the surface, or look at the contracts, and that’s not actually what’s been happening,” she said. She added that “... at a fundamental level [the plaintiffs] just have their facts wrong”—a point she said defendants have been making in their motions to have the suits dismissed.

Plaintiffs’ attorneys have responded to those motions with some creative arguments, Hill conceded, “and with an effort to confuse things for the courts, who may not have seen, or may not be accustomed to seeing, this type of product, or to looking at these types of contract provisions in this level of detail.” She said plaintiffs’ attorneys “have done a decent job of confusing things, at least on paper”.

The insurance-company lawsuits also allege that the insurers violated ERISA’s 408(b)(2) disclosure requirements “by not disclosing the difference between their internal rate of return and the crediting rate.” The argument is that this so-called “spread” constitutes direct or indirect

“It’s what I call Goldilocks litigation: either it’s too risky or too conservative; never just right.”

compensation and so should have been disclosed. The suits also claim the insurers placed transfer restrictions and/or “punitive” financial penalties on their stable value funds, thereby preventing retirement plan customers from moving out of the funds.

“I think when the 408(b)(2) disclosure rules came out, we all thought it was just a matter of time before we would see these issues raised in litigation,” Richman said. “They’re attacking a gray area where we didn’t get any further guidance.”

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In another case against an insurance company, *Rozo v. Principal Life Insurance Co.*, the plaintiffs have alleged that a guaranteed investment contract offered by the insurer was not a guaranteed benefit policy exempt from ERISA’s fiduciary rules, and that the insurer’s actions in setting the crediting rate for the GIC violated ERISA. In what Hill called a “very short and not thoroughly reasoned decision,” a court relied on that allegation in denying the defendant’s motion to dismiss the case.

“Prudence is a high standard, but it’s also intended to be a flexible standard—not to mandate specific investments.”

In the wake of lawsuits claiming that stable value providers somehow harmed retirement plan participants, perhaps the most surprising new set of lawsuits are those claiming that fiduciaries should have offered stable value funds to retirement plan participants instead of money market funds. Richman and Hill cited two examples: *Bell v. Anthem Inc.*, and *White v. Chevron Corp.* The basic argument in both suits is the same: the defendants

imprudently offered money market funds with extraordinarily low yields, when higher-yielding stable value funds offering similar principal preservation features were available.

As appealing as those lawsuits might seem to the stable value community, Richman cautioned that “there is some concern about the concept that it’s per se prudent or imprudent” to offer or not offer any one investment product, across the board, in all plans. “Prudence is a high standard, but it’s also intended to be a flexible standard—not to mandate specific investments,” he said.

Asked whether the plaintiffs’ attorneys filing lawsuits against plan service providers might face any ramifications if the suits are found to have been frivolous, Hill called it a great question she gets from many of her clients. Unfortunately, she said, if past practice is any indication, plaintiffs’ lawyers won’t face any consequences.

Hill also was asked what firms might be doing to prepare themselves in the event of a lawsuit. In the case of *Goldilocks* cases questioning the prudence of a stable value fund’s investment strategy, she said, documenting the process used to arrive at that investment strategy could be helpful in mounting a defense. **SVIA**

The implication, Hill said, is that the insurers simply decided how much they wanted to earn and set their crediting rates accordingly. “You scratch the surface, or look at the contracts, and that’s not actually what’s been happening.”

Leadership: The Other Stable Value

By Randy Myers

In early April, the U.S. Department of Labor finally issued its long-anticipated new rule extending fiduciary responsibility to anybody who is compensated for providing investment advice, whether to individuals or retirement plans. In a nutshell, it requires fiduciaries to act in the client's best interest.

Sounds simple. But the so-called streamlined rule is 1,028 pages long, takes 208 pages to define who is a fiduciary, and spends 317 pages explaining the best interest contract exemption.

As consultant Don Trone, founder and CEO of the research and training firm 3ethos told participants at the 2016 SVIA Spring Seminar, being a fiduciary is exhausting. But leadership, he countered, is exhilarating. He defined it as the ability to inspire and the capacity to serve others, and argued that fiduciaries will help their cause by embracing leadership.

Leadership qualities are especially important for fiduciaries, Trone said, because of the levels of mistrust associated with the financial services industry. He cited a 2015 Global Market Sentiment Survey by the CFA Institute in which 96 percent of the institute members polled said there is a lack of trust in the industry, with 63 percent citing a deficit in the industry's ethical culture as a leading cause.

Trone said the DOL rule focuses on fiduciary responsibility in three areas: defining the roles and responsibilities of key decision-makers; preparing periodic reports that analyze fees, expenses and return on investment; and conducting periodic examinations for conflicts of interest and self-dealing. He urged retirement plan fiduciaries to go beyond those three areas by addressing other responsibilities, including stating goals and objectives for their plans, identifying sources and levels of risk and assets, identifying time horizons and expected outcomes, preparing a written strategy statement, defining the process for selecting key personnel to implement the strategy, and preparing periodic reports that analyze the strategy's performance.

The ideal, Trone said, isn't just to meet the minimum requirements of a fiduciary as spelled out by the DOL, but to be what he called an "ethotic leader," someone who combines the attributes of leadership with those of stewardship and governance. He defined stewardship as the "passion and discipline to protect the long-term interests of others" and governance as "the ability to demonstrate the management of a prudent decision-making process." He argued that those three terms, especially taken together, denote a higher sense of ethical discernment than "fiduciary." **SVIA**

New York Life Fixed Income Manager Sees Continued US Economic Growth, Fixed-Income Opportunities

By Randy Myers

It's easy to be worried about investment risk right now. China, the world's second largest economy, is experiencing growing pains that have sent oil and other commodity prices tumbling. China's attempts to transition from an economy built on government infrastructure spending to one built on consumer spending is going to be tricky. Meanwhile, Japan and parts of Europe are employing negative interest rates in a bid to boost their economies, a move critics speculate could backfire. The U.S. economy continues to move forward, but neither so fast nor so slow that anyone is certain what the Federal Reserve will do next on monetary policy. The UK will vote in June on whether to

exit the European Union, the U.S. is barreling toward another potentially divisive presidential election, and geopolitical risks of all sorts remain a constant.

"Overall, the global economy is still plagued by sluggish, modest, weak growth," said Tom Girard, senior managing director and head of fixed income investors for New York Life Investors, during a talk at the 2016 SVIA Spring Seminar. "We have relatively low inflation, and in fact deflation in some parts of the globe. We continue to see central

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New York Life Fixed Income Manager Sees Continued US Economic Growth, Fixed-Income Opportunities

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banks looking to provide ways to support the economy, all leading to bouts of dramatic volatility in the financial markets. I'm not a central banker, but if I was, I think I would come out of one of [their] meetings and hold up my hands and yell for help."

The help Girard has in mind, he said, would include regulatory and tax reforms addressing issues such as social programs, entitlement spending and immigration.

For all that, Girard argued that the outlook for fixed-income investors isn't as bad as it might seem. The International Monetary Fund continues to forecast that the U.S. and the world economy will avoid recession in 2016, he noted, with the U.S. economy growing at perhaps a 2.5 percent rate, or a bit above what it did in 2015.

"The U.S. is the most stable economy right now around the globe," Girard said, adding that he considers it halfway between mid-cycle and late stage. That would put it several years from another recession. "I know there's frustration with the strength of the recovery, but you can't argue with the durability of it," he said. "We're going into the seventh year of economic expansion, the third longest in the post-World War II era."

Girard attributed the strength of the U.S. economy in large part to the health of the labor market, which he said has performed "remarkably well" since the financial crisis. Over that time, it has generated more than 12 million jobs, which has sent the unemployment rate down from a peak of 10 percent to 5 percent, a figure likely to move lower through the balance of 2016. Girard said consumers are feeling pretty good about their household net worth, which is at an all-time high, and about the recovery in the housing market, which has sent home prices in many parts of the country back to pre-crisis levels. At the same time, he said, consumer debt-service payments are at their lowest levels in 30 years, and low oil prices are putting more spending money in consumer pockets. U.S. inflation has remained modest throughout the recovery, and Girard said his firm's forecast is for inflation to remain "relatively well-behaved," allowing the Fed to continue to be

patient in raising interest rates.

Against that backdrop, Girard said fixed-income managers, including stable value managers, have a number of attractive investment opportunities available to them. He said he "wouldn't be looking to take a lot of interest-rate risk right now," and would focus on the two-year-to-five-year part of the yield curve.

"Where we're most comfortable taking risk has to do with asset allocation," he continued. He said he saw opportunities in corporate bonds, where valuations still looked attractive on a historic basis. Among the best-positioned sectors, he said, were financials, including insurance companies, large U.S. banks, some Canadian banks and select European banks. He also mentioned industrials, including energy, where he said some relatively solid credits have been sold off over the past two years as oil prices have plunged. Still, he stressed that security selection will be critical throughout the corporate sector. "We don't think valuations are so cheap that it's a sector play where you can just allocate to the sector and forget about it," he said. For stable value portfolios, Girard said, commercial mortgage-backed securities offered "reasonably attractive" valuations and "pretty healthy" fundamentals. He said AAA-rated paper and asset-backed securities in the two-to-five-year portion of the yield curve also looked attractive. He urged investors to be cautious in the mortgage-backed securities sector, but observed that opportunities might occasionally present themselves there during periods of market volatility.

"In spite of all the risks and uncertainty out there," he summarized, "I think you're looking at a situation where you're going to get more of the same from the economy, with modest to sluggish growth. You're probably still going to get relatively tame inflation, and central banks will still be playing a significant role in terms of trying to help economies. I think for stable value portfolios it's going to be about yield, and taking advantage of volatility in the market—finding those pockets of attractiveness and putting yield into the portfolio to create some outperformance for clients." **SVIA**

How Gender and Generation Impact Retirement Saving

By Randy Myers

Men and women aren't really from different planets, no matter what psychotherapist John Gray argued in his 1992 best-seller. But men and women tend to behave differently when it comes to saving and investing for retirement.

In a 2015 study of male and female participants in more than 2,000 defined contribution retirement plans, researchers at the Vanguard Center for Retirement Research found that women participate in their plans at higher rates than men, and also save more. But despite higher levels of participation and savings among women, men held higher account balances due to higher salaries. However, the growth of automatic enrollment as a retirement plan design feature is starting to narrow the gap.

Cynthia Pagliaro, a senior research analyst with the Vanguard Center for Retirement Research, presented these findings during a presentation at the 2016 SVIA Spring Seminar. In the plans that Vanguard studied, she said, 73 percent of eligible women participated in their retirement plans, versus 66 percent of eligible men. The numbers were skewed even more where enrollment was voluntary; in those cases, 66 percent of eligible women participated, versus 58 percent of eligible men. But where enrollment was automatic, 89 percent of both genders participated.

Savings rates followed a similar pattern. Women deferred 7 percent of their salary on average, versus 6.8 percent for men. Women participating in their plan voluntarily saved 7.5 percent, versus 7.1 percent for men. But where enrollment in the plan was automatic, men actually saved more: 6.2 percent of salary, versus 5.9 percent for women. Men, Pagliaro said, show a greater propensity to override their plan's default savings rate.

Neither gender is particularly savvy when it comes to personal finance and investing, however. Asked three financial literacy questions, only 25 percent of women and 40 percent of men answered all three correctly. Even among college graduates, Pagliaro said, only 44 percent of those surveyed got all three answers right.

In terms of how they invest, women and men allocated similar amounts to equities—73

percent of assets for women, 74 percent for men. However, men were 50 percent more likely to trade within their accounts. It didn't seem to hurt their investment returns, though. Over the past five years, Pagliaro said, men earned a median return of 10.9 percent in their retirement accounts, versus 10.6 percent for women.

There were, however, big gender-based differences in retirement account balances. Among women, the average account balance was \$79,572, versus \$123,262 for men. The median account balance among women was \$24,446, versus \$36,875 for men. The explanation, Pagliaro said, was not in the average age or tenure of the male and female participants. Rather, it was income: men earn about 25 percent more than women. Pagliaro said one recent study suggests that over half the wage gap can be explained by occupational choice or opportunity. Women, she said, are more likely than men to have lower-paying jobs.

On a brighter note, Pagliaro said the wage gap between men and women is improving. "Back in the late 1970s it was about a 40 percent differential, now it's 20 percent or 22 percent, much of it driven by increased educational levels among women," Pagliaro said. "In fact, women today are far more likely to graduate from college than men. That was not the case in the late '70s. There also are more women in the workforce today, so more work experience is leading to that gap closing."

In addition to looking at how saving and investing patterns differ by gender, Vanguard also looked at how those patterns differ by generation. To do that, it first classified participants into four generations: millennials (between the ages of 18 and 34), Generation Xers (between the ages of 35 and 49), late baby boomers (between the ages of 50 and 59), and early baby boomers (between the ages of 60 and 69). Vanguard looked at what each of those generations was doing in 2013, then looked back at what people of the same age were doing in 2003. For consistency, it looked only at plans that Vanguard continuously administered during that 10-year-period.

How Gender and Generation Impact Retirement Saving

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“In terms of retirement plan savings, all generations have experienced improvement over that 10-year period,” Pagliaro said. “However, the largest improvement is accruing to the millennials, with much of that driven by auto enrollment.”

In 2003, only 51 percent of eligible employees between the ages of 18 and 34 were participating in their workplace retirement savings plans, Pagliaro said. By 2013, that percentage was up to 87 percent. Gains for the other age groups were smaller; for late boomers, for example, the participation rate rose to 92 percent from 73 percent.

For each age group, contribution rates have improved, too. Today's millennials were contributing 6.6 percent of their salary to their plan in 2013, for example, up from 4.2 percent for that age group in 2003. Those figures include both

participant contributions and employer matches, Pagliaro noted.

Pagliaro said millennials are very concerned about investment risk, having already lived through two great bear markets. The first began with the bursting of the tech-stock bubble in 2000, the second with the real estate crisis that erupted in 2007. Nonetheless, Pagliaro said, millennials seem to be doing better in terms of portfolio diversification than participants their age a decade earlier. “Automatic enrollment and default deferrals into target-date funds seem to be helping,” she said. In auto enrollment plans, she said, Vanguard sees significant adoption of professionally managed asset-allocation strategies, either in the form of target-date funds, other types of balanced funds or managed account programs. Those adoption rates, she added, are highest among millennials. **SVIA**

Stable Value in the Spotlight

By Jacob Punnoose, Aon Hewitt

Sleepy. Quiet. Those are a couple of words that have been used to describe the capital preservation arena over the years. But with money market reform, we have seen capital preservation become one of the more significant investment policy topics during defined contribution (DC) client review meetings this year.

Most DC plans presently offer a stable NAV product such as a stable value fund or money market fund. According to Aon Hewitt's 2015 Trends & Experience in Defined Contribution Plans report, 74% of DC plans offer a stable value fund while 40% offer a money market fund (some plans offer both). For plans that offer a money market fund, money market reform has brought this fund category to the forefront of discussions. In a nutshell, DC plans that wish to continue to offer a money market fund are being faced with two general options – offer a retail money market fund that potentially may have gates and/or liquidity fees imposed or a Treasury/government money market fund. For plans that wish to offer a retail money market fund, a practical limitation is that most recordkeeping platforms have made the decision not to support such funds due to the potential complications around gates and liquidity

fees. And offering a Treasury/government money market fund is not deemed as overly attractive by many plan sponsors given depressed yields and low expected returns.

As a result, we are seeing a tremendous amount of stable value interest and search activity. Some plans have moved or are in the process of moving to stable value funds. It should also be noted that while some plan sponsors have elected to move from current money market offerings to Treasury/government money market funds in advance of the October 2016 reform implementation, an opportunity will continue to exist for stable value managers to discuss stable value with these plan sponsors even beyond that date. With the potential for meaningful additional return of stable value funds over Treasury/government money market funds, we believe that there could be a tail of stable value opportunities that extends beyond October 2016.

From a longer-term perspective, we believe that it is critical for the stable value industry to understand the evolving focus of DC plan sponsors and determine how stable value can be an important part of the solution.

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Stable Value in the Spotlight

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Now the question is solution to what?

In years past, DC plans were viewed as just one of the parts (and in many cases, a minor part) of the retirement equation. But with the closing and freezing of many DB plans and questions about the future of Social Security, DC plans have become more and more vital for participants. As a result, the efforts of many DC plan sponsors have changed from simply driving increased employee participation rates to determining how to improve retirement income adequacy. The stable value industry's task is to determine how stable value can be part of the retirement income adequacy solution.

First, is it important to DC plan sponsors that there is a stable NAV product in the plan lineup? Our experience has shown that plan sponsors view a stable NAV product as an essential piece of the plan lineup puzzle. As we have both encouraged and seen streamlining of DC plan lineups, we have witnessed the capital preservation option as becoming relatively more important in serving as a truly differentiated option. Then the natural question becomes, "What is the right capital preservation option?" As mentioned earlier, stable value has been the favored choice of plan sponsors given its similar expected volatility and higher expected return in comparison to that of money market funds, and we expect that this preponderance of stable value will only grow given the effects of money market reform.

As plan sponsors focus more on helping drive stronger retirement income adequacy, our research

indicates that there are three primary levers:

- Increasing savings (contributions flowing into the plan)
- Improving investment efficiency through diversification/controlling costs
- Delivering more return through simplification and broadening of the investment mandates.

On the point of controlling costs, scale of plan assets is an important factor, and more plan sponsors are seeking to encourage participants (and corresponding assets) to remain in the plan even after the participants retire. One favorable attribute for stable value is it is a fund type that is only offered in a qualified plan context, and stable value is generally of high potential utility for those nearing and in retirement. It is important for the stable value industry to remind the broader DC community of such key attributes of stable value.

In recent months, we have witnessed quite a bit of activity with stable value and there is a significant opportunity for stable value to gain market share in the capital preservation space given the changes to money market funds. In terms of the long-term value proposition of stable value, it is critical that stable value find its role in helping DC plan sponsors achieve broader plan goals such as improving retirement income adequacy. **SVIA**

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Stable Value Roundtable: Stable Value Industry Strong, Getting Better

By Randy Myers

The stable value industry is in great shape, according to industry veteran Aruna Hobbs. It's healthy and vibrant, with plenty of capacity. Cash flow is stable, and the asset class continues to deliver on its promise of principal preservation and steady returns for retirement plan participants.

While the trajectory of the industry is positive, like all asset classes, stable value is responding to developments in the marketplace. Plaintiffs'

lawyers have filed a succession of lawsuits alleging that stable value providers and plan sponsors have breached their fiduciary duties. Low interest rates continue to pressure stable value returns. And impending new rules for money market funds are prompting some retirement plans to rethink their commitment to those funds, with some indicating they might replace them with stable value funds.

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To find out how the industry is responding to these developments, Hobbs, senior managing director and head of institutional investments for MassMutual, led a roundtable discussion with several of her peers at the 2016 SVIA Spring Seminar. She invited the audience to participate via instant polling. Joining her on the panel were Tom Felago, business development manager in Wellington Management's U.S. Financial Intermediaries Group; Jennifer Gilmore, head of stable value portfolio management for Invesco Fixed Income; and Tom Schuster, vice president, corporate benefit funding for Metropolitan Life Insurance Co., and head of MetLife's Stable Value Investment Products Division.

Hobbs launched the discussion by asking her audience what the capital preservation option should be in a defined contribution retirement plan—a stable value fund or a money market fund. Not surprisingly, more than three-quarters of the respondents answered stable value. But 21 percent said stable value and money market funds could coexist peacefully. None thought money market funds should be the sole option.

Next, Hobbs asked which of four major issues is likely to impact defined contribution plans the most in the years ahead: increased litigation, fee pressures, the movement away from active investment management to indexing, or regulatory change. Fifty-two percent of the audience cited litigation, followed by 23 percent who cited regulatory change. Schuster agreed with those who chose litigation, noting that the entities named in recent lawsuits represent a broad group, including plan sponsors, insurance companies and service firms. In short, he said, it's everyone tied to the retirement plan industry. He also worried that news articles reporting the lawsuits will attract more attention than any later articles reporting their dismissal. That could have a negative impact on plan sponsors' view of stable value.

Felago said that while he personally considers fee pressure a more important trend, he understands the concerns about litigation. Because of the stable value market's size, he said, and the long-standing use of stable value in retirement plans, litigation is likely to remain an issue for some time.

Still, Felago said, stable value faces both challenges and opportunities. The worst outcome on the litigation front, he said, would be that plan sponsors conclude there's just too much risk associated with stable value and that it's not worth their time. On the other hand, he said stable value is uniquely positioned to resist the trend toward indexing. "It's impossible to just passively replicate stable value, and the value it provides participants," he said. "That's really, really powerful." Ultimately, he said, plan sponsors might conclude that if there is any asset class where it's worth paying for active management, stable value is it.

Felago also sees an opportunity to promote stable value by further educating plan sponsors and their advisors about how much better stable value funds have performed, historically, than money market funds or inflation. Earlier, Schuster had shared results of a MetLife study indicating that many plan sponsors weren't aware of how much better stable value has done. "We need to make sure people are clear on the difference, and what we're providing for participants," Felago said. "I think that, ultimately, is what will protect us."

On the fee front, Gilmore and Felago agreed that it will be important for the stable value industry to provide additional clarity and transparency about costs. Plan sponsors, Gilmore said, want to know not just how much they're being charged, but why. "Help me understand what goes into your pricing," she said. "The fee has to make sense."

Seeking to drill down further on what her peers consider the most important issues confronting the stable value industry, Hobbs asked her audience what keeps them up at night. Options included the possibility of interest rates rising and spreads widening, of rates remaining low or falling, and "other things." "Other things" polled highest, followed by "I sleep well," then "low or falling rates."

Gilmore said she worries most about making sure that stable value remains a relevant asset class, particularly as target-date funds continue to attract increasing volumes of defined contribution plan assets. To help keep stable value relevant, she said, it will be important that stable value funds be incorporated into future products introduced by the financial services industry.

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Schuster was sympathetic to Gilmore's concerns, warning that if the industry isn't able to replace money market funds and short-duration bond funds with stable value funds in target-date funds, the asset class will be in a different and less favorable position 20 years from now. He said he spends a good bit of time trying to figure out how stable value could be incorporated into a "non-40 Act, mass-marketed, target-date fund."

Felago identified low rates as an important concern, calling them "crushing" for retirees and anyone else who needs income. But he also said that in an environment where every 10 or 20 basis points of return matters, the yield advantage that stable value offers over money market funds is a marketing opportunity.

Like the audience, the panelists generally agreed that the stable value industry has not forgotten the lessons of the financial crisis, although Gilmore said she was glad to see stable value investment guidelines easing a bit, so that investment managers have greater flexibility to do their jobs. Hobbs concurred, but cautioned that "we want to be careful we don't go down the slippery slope where, in five or 10 years, we're wide open again, with the same errors made before the crisis perhaps made again." Schuster said the crisis taught the industry that investment guidelines should not be based purely on quantitative factors, but also should take into account an investment manager's experience and expertise.

About two-thirds of the audience agreed that the most common response by plan sponsors to looming money market reforms will be to switch from prime money market funds to government money market funds, which won't be subject to new liquidity gates and redemption fees. Another 24 percent expect plan sponsors to switch from money market funds to stable value funds, and about 7 percent expect sponsors to switch to laddered portfolios of ultra-short fixed-income securities.

Only 11 percent of the audience said they could imagine stable value management becoming more passive, or indexed, but a hefty 38 percent said it might happen. Still, that left 51 percent who said it won't.

Hobbs asked the audience where they see the biggest opportunities for the stable value industry—in the wider incorporation of stable value

funds into target-date funds, in the higher use of managed accounts, or in making stable value a part of new retirement income solutions. Nearly 39 percent cited the target-date option and 16 percent voted for retirement income solutions, while 45 percent said "all of the above."

Schuster noted that the stable value industry might benefit indirectly from new Department of Labor rules requiring investment advisors to always act in the best interest of their clients. Right now, he said, about \$400 billion is rolled out of workplace retirement plans into IRAs each year. Some experts argue that workplace plans, featuring low-cost investment options vetted by an investment committee, are a better deal than IRAs. If the new DOL rules simply cut by half the volume of IRA rollovers, Schuster noted, it would result in an additional \$200 billion staying in workplace retirement plans each year. Workplace plans, of course, are generally the only place where stable value is an investment option. "Through no effort of our own, that might be a substantial growth opportunity, and probably near-term one that exceeds many other opportunities," Schuster said.

Hobbs said opportunities for stable value related to retirement income solutions may depend upon what fiduciary protections are granted to those products. "If that comes out positive, we might see greater interest in these solutions," she said, adding that "there may be a spot for stable value in them as a way to provide principal protection."

Hobbs concluded the roundtable discussion by asking audience members whether they felt there was enough capacity in the stable value market to withstand another market disruption. Nearly 36 percent said "yes," 13 percent said "no," and 51 percent said it depended on the nature of the disruption.

"I would have thought most people would say 'yes,'" Hobbs observed. "In the last SVIA survey, when contract issuers were asked how much additional capacity they could provide, the answer was around \$80 billion. That's a substantial number."

Hobbs added that beyond looking at data like that, she could gauge the health of the stable value industry by the number of events taking place at the SVIA seminar and the amount of networking and other activity taking place there. On that score, she concluded, the industry appeared healthy indeed. **SVIA**

Can Stable Value Funds Keep Pace with Inflation?

Firoza Panthaki, CFA and Michael Sipper, CFA

The financial markets have historically experienced volatility and market uncertainty, which remain key themes in today's markets. Investors saving for retirement are challenged to find strategies to generate enough income after inflation to last through their retirement years. Even modest inflationary pressures can eat into retirement savings and reduce actual purchasing power of money. This is especially true for investors approaching retirement age looking for stable returns and also investors who cannot tolerate market swings. An investment option that could help in these situations is a stable value fund.

Although stable value offers smooth and predictable returns, critics suggest that stable value may not be able to keep pace with inflation. Inflation is a measure or estimate of a general increase in the overall price level of the goods and services in the economy and results in a decrease in the purchasing power of money over time. For example: We pay more for a loaf of bread today than we did twenty years ago.

Investment returns are most often presented in nominal values, where the value of a fund today is compared to the value of the fund in a prior period. The value of an investment return in real dollars is actually less than the nominal return presented to investors on their portfolio statements because of the impact of inflation. If your portfolio increased

(CPI) where the CPI represents a "basket" of items (i.e., goods and services that people purchase for day-to-day living). Every item in this basket has a price, which changes over time. The annual rate of inflation is the price of the total basket in a given month compared with its price in the same month one year previously, the "CPI value".

Why is real return important? Despite recent years of slow economic growth, prices have increased over time. According to Poul Kristensen, CFA, Managing Director and Economist at New York Life, "Inflation may be low by historical standards, but it is not zero, and the current low yield environment therefore brings challenges for many investors. Over time, inflation can significantly erode the purchasing power of savings, and investors planning for retirement need to focus on real, i.e. inflation-adjusted, returns when allocating their investments." Even though the overall CPI may be low, it could adversely impact consumers depending on what items they purchase. For example, increases in food prices may have a greater impact than a change in energy prices.

New York Life examined the impact of inflation on stable value returns and other conservative investment products to determine if investors are able to keep pace with rising prices using CPI.

In order to show the impact of inflation using CPI, we compared the growth of a dollar in nominal and real returns for stable value funds (based on a hypothetical portfolio as published by SVIA), money market funds (as measured by iMoneyNet), and the Barclays Capital U.S. Intermediate Government/Credit Bond Index from 1990 to 2015. We also examined the standard deviation⁵ of returns for the three asset classes to compare volatility in returns.

In table 1, we can see that all three products were able to keep pace with inflation. However, only

TABLE 1: COMPARISON OF GROWTH OF A DOLLAR

	PERIOD 1990-2015			
	CPI ¹	Barclays Int Gov/Credit Index ²	Stable Value ³	iMoneyNet ⁴
Nominal Return	\$1.87	\$4.31	\$4.33	\$2.08
Real Return (net of CPI)	n/a	\$2.31	\$2.32	\$1.11
Standard Deviation ⁵		11.14%	1.82%	2.31%

Returns are gross of all fees and expense which, if included, would reduce the returns shown. The duration of the index and stable value funds are longer than money market funds.

five percent but inflation was two percent for that same period, your portfolio actually only earned three percent when adjusted for purchasing power. This is known as your "real return", or return after inflation.

Inflation is measured by the Consumer Price Index

Can Stable Value Funds Keep Pace with Inflation?

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stable value funds and bonds were able to provide income over the rate of inflation. Real returns for stable value funds and bonds more than doubled over the period, whereas money market fund real returns were essentially nonexistent. Although

The results were consistent with what New York Life uncovered during the longer single period; stable value fund and bond fund returns are competitive in each period on both a nominal and real basis. Despite anemic inflation growth

TABLE 2: GROWTH OF A DOLLAR INVESTED IN SELECTED TIPS AND OTHER CONSERVATIVE PRODUCTS

TIPS Security ⁶				Nominal Growth of \$1				Real Growth of \$1			
Cusip	Origination Date	Maturity	Coupon	TIPS	SVFund ³	iMoneyNet ⁴	Bond Index ²	TIPS	SVFund ³	iMoneyNet ⁴	Bond Index ²
9128273A8	7/9/1997	7/15/2002	3.625%	\$ 1.33	\$ 1.39	\$ 1.25	\$ 1.43	\$ 1.20	\$ 1.23	\$ 1.11	\$ 1.27
912828CZ1	10/26/2004	4/15/2010	0.875%	\$ 1.18	\$ 1.31	\$ 1.15	\$ 1.28	\$ 1.05	\$ 1.15	\$ 1.02	\$ 1.13
912828MY3	4/26/2010	4/15/2015	0.500%	\$ 1.12	\$ 1.17	\$ 1.00	\$ 1.18	\$ 1.03	\$ 1.08	\$ 0.92	\$ 1.08

stable value fund returns were comparable to the Barclays Intermediate Government Credit Index, they had very little volatility as demonstrated by the low standard deviation.

Money market funds, on the other hand, offer the same level of stability as stable value funds but with generally lower returns. Currently, some money market fund returns are unable to keep up with inflation, with annual rates of 0.02% (iMoneyNet MFR).

Using Treasury Inflation Protection Securities or "TIPS" with five year maturities, we can compare actual inflation-protected investable securities to investment option returns available in defined contribution plans. New York Life found three five-year bonds issued as far back as 1997 that covered the periods listed in table 2.

from 2010 through 2015, money market fund real returns were negative. Stated another way; Investors lost purchasing power by investing in money market funds.

Although stable value funds and bonds had comparable returns over the period, the volatility experienced with investing in bonds may be hard to stomach for investors approaching retirement. In sum, adding stable value as a fundamental component of your retirement plan, especially as you approach retirement not only provides capital preservation of your assets but in the past has also kept up with inflation while providing steady returns. **SVIA**

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Footnotes:

1. CPI from US Bureau of Labor Statistics. <https://research.stlouisfed.org/fred2/series/CPIAUCSL/downloaddata>.
2. Barclays Capital U.S. Intermediate Government/Credit Bond Index measures the performance of U.S. Dollar denominated U.S. Treasuries, government-related and investment grade U.S. corporate securities that have a remaining maturity of greater than one year and less than ten years.
3. Stable Value Hypothetical Returns from Stable Value Investment Association are based on underlying investments in the Barclays Intermediate Government/Credit Index. (www.stablevalue.org)
4. Money Market Funds (iMoneyNet Money Fund Report) iMoneyNet, Informa Business Intelligence Inc., is the leading provider of money-market mutual fund and enhanced cash Information - serving institutional clients worldwide.
5. Standard deviation is a statistical measurement that is used to calculate historical volatility; the higher the standard deviation, the higher the volatility/risk of the asset class. Standard Deviation based on annual nominal returns.
6. <http://www.treasurydirect.gov>