Stable Times

Newsletter of the Stable Value Investment Association

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GIC Issuers Look to Foreign Markets for Growth

by Greg McGreevey, CFA, ING Institutional Markets

Introduction

Slowing growth of the stable value market coupled with the increased use of GIC alternatives such as synthetics has led many traditional GIC issuers to begin to cultivate new markets for their general account products. One of the first complementary sectors was the funding agreement market, in which floating rate products with a short-term put provision were sold to institutional investors such as money market funds, securities lending programs, and corporate cash accounts. It is estimated that over the last several years, total sales of funding agreements have nearly doubled to $13 billion with about 10 active issuers. While demand for these products remains quite strong, a number of insurance carriers are looking to international markets to tap a new set of investors and increase sales.

Why International?

There are a number of reasons for insurance companies to pursue the international markets. First, this market helps improve the carrier's liability structure through the issuance of longer-term liabilities that can be issued without embedded put provisions. Such issuance is beneficial in managing the average life spread risk that often exists between domestic funding agreement products and the assets supporting them. In addition, entrance into foreign markets expands a carrier's distribution channels and further diversifies its funding sources, while also positioning these issuers to respond to sales opportunities as changes occur in international pension systems. Finally, this segment offers the potential for attractive funding to the issuer, especially when examined on a risk-adjusted basis.

Illustrative Structure

The diagram below provides a generic overview of the structure of many of the transactions completed in the European market to date. Typically, the insurance company establishes an offshore special purpose corporation (SPC) in a suitable location such as the Cayman Islands. The SPC then issues medium-term notes to international buyers that are backed by a funding

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In This Issue

Proposed Legislation Expands Bankruptcy Protections For Derivatives

by Perry Shwachman, Katten, Muchin and Zavis

On August 4, 1998, House Banking Committee Chairman Leach introduced a bill, the Financial Contract Netting Improvement Act of 1998, H.R. 4393 (the "Netting Improvement Act"), which would increase the level of protection given to parties transacting in derivatives in the event that a counterparty becomes insolvent. Among other things, the proposed legislation expands the types of financial contracts protected from the automatic stay issued under the Bankruptcy Code, prevents payments under such contracts from being voided as preference payments, and precludes an insolvent bank from "cherry picking" among contracts it will honor with a counterparty.

For stable value participants, the ramifications provide both greater certainty in dealing with derivative products, as well as new investment opportunities with higher returns and less risk. Both stable value managers and wrap providers use various derivatives and other financial contracts,

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Editor's Corner: Innovation, the Key to Future Growth

"Resisting change is like holding your breath, if you persist you will perish"
— Lao Tao

Globalization. Technology. Consolidation. Whenever I find myself contemplating change, I think of this quote made by an ancient Chinese philosopher, Lao Tao, some two thousand years ago. Though delivered long ago, his message of embracing change seems as relevant today (if not more so) as it was then. Fortunately, the stable value industry, after experiencing a decade of continual change, adaptation and reinvention, seems well poised to meet the challenges of the future. Indeed, with the go-go days of stable value behind us, issuers, wrap providers, and managers have all begun to explore an pioneer other markets to generate growth in the future. The following is a small sample of what has been taking place.

Issuers, who historically distributed the majority of their contracts to the qualified plan market, have now diversified their investor base to include money market mutual funds & securities lending pools through the issuance of funding agreements. Some issuers have begun to tap the demand by foreign investors for guaranteed products through the establishment of offshore trusts. In fact, one such structure is described in detail in this issue.

Synthetic GIC providers also continue to seek additional applications/markets for their wrap structures. Wrapping equities and balanced funds has been the subject of much discussion and some activity for years. And like their GIC issuer counterparts, innovative wrap providers have begun to complete transactions with non-qualified investors such as insurance companies (for balance sheet purposes) or offshore trusts. One provider has recently provided a wrap on a market neutral hedge fund.

Not to be outdone, stable value managers have been on the move as well. The registration of the first stable value mutual fund has opened the door to other markets such as 403(b) plans, IRA rollovers and ultimately perhaps, even retail investors. It is estimated that there are as many as six additional stable value mutual funds currently in the process of registration. Multi-manager structures have also begun to appear with one insurance company offering the first multi-manager pooled stable value product within a separate account structure. Managers are also pursuing other markets such as the public funds arena, which has historically been dominated by insurance companies.

While difficult to predict at this stage, change and reform in the global pension arena may provide yet another important growth market to stable value industry participants who possess the necessary resources to participate.

Technology is yet another area where change has improved industry efficiency and effectiveness by leaps and bounds. While examples in this area are too numerous to cite, the introduction of sophisticated portfolio modeling and analytical systems has been especially beneficial in terms of allowing more effective portfolio management. Additionally, the development by one consultant of a system which provides issuers and wrap providers up-to-date Internet access to uniform plan data from stable managers is an exciting development, long overdue. The system also provides a centralized data base containing comprehensive aggregate market data. Welcome to the next millennium.

Clearly, the future presents opportunities as well as uncertainties for the stable value industry. Please join us at the upcoming SVIA National Forum, October 27-29, in Washington, D.C., to discuss these and other important issues. I think you'll find especially intriguing our Special Half-Day Forum, which is dedicated to exploring new frontiers and products - your gateway to the future of stable value. We hope to see you there.

Karl Tourville
Associate Editor

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Letter from the Chairman

Since our last Stable Times was published in June, at least three significant events have transpired in the Nation's Capitol: 1) the tragic shooting-deaths of two Capitol Hill Police officers; 2) the travesty of the Lewinsky/Clinton grand jury testimony; and 3) perhaps of most direct interest to SVIA members, the resignation of SVIA's President, Cindy Hargadon. Tragedy, travesty, and transition. Events that move us outside of our comfort zones and into the business of Change.

While I think it is safe to say that most of Washington is still reeling from the aftershock of the first two events, and it is definitely not "business as usual" in the Nation's Capitol, I am pleased to report that no such lapse has occurred at SVIA. Although Cindy is sorely missed, the work of the Association has continued apace without missing a beat in spite of her absence, as both Washington staff and the Board of Directors have chipped in to fill the gaps, particularly regarding planning and development of the October 1998 National Forum. While the search is still underway for a new President, rest assured that the Association is forging ahead with its projects while energetically preparing for its top priority, the 1998 National Forum.

I'd especially like to share with you some of the plans for this year's Forum, because people still tell me what a great meeting we had last year, and our 1998 Forum is shaping up to be even better. They talk about how far-reaching and substantive the topics were and about what stimulating speakers we had. This year's Forum will not disappoint you either, thanks to the hard work and dedication of the National Forum Task Force and its Planning Committee. At this time, I would like to give my special thanks to those individuals, because they have shown the commitment and perseverance that have become the hallmark of so many of our volunteer efforts. They are: Christina Aragon, Peter Bowles, Patrick Boyle, John Clay, Wendy Cupps, Sharon Egilinsky, Doris Fritz, Cynthia Hargadon, Marla Kreindler, Keven Maloney, Jon Mercier, Doug Peabody, Perry Schwachman, and Bruce Vane.

And now, for the 1998 Forum. First of all, in light of the upcoming election and the upheaval in the Clinton administration, we have selected two dynamic public speakers from the world of the media to appear in our keynote slots: Day One (October 28) will feature Chris Matthews, the hard-hitting host of *"Hardball With Chris Matthews*" on CNBC. Mr. Matthews is known in journalistic circles as an "in your face" type of analyst, who is not afraid of controversy and certainly not afraid to speak his mind. For that time slot we have also invited Senator Rick Santorum (R-PA), an active policy maker in the retirement arena, although we are not sure he will be able to make it.

On Day Two (October 29), we have selected Mike McCurry, soon-to-be-ex Press Secretary for the Clinton spin machine. While we are still engaged in negotiations with his agents (who are in turn engaged in negotiations with White House Counsel), we are cautiously optimistic about being one of the first organizations to be able to hear directly from Mr. McCurry on the political prognostications for the coming election cycle and politics in general.

You should have received an early-bird mailer about the Forum by now, which lists the scheduled session, topics, and speakers, but I will hit on a few highlights here anyway. (By the way, I would encourage you to take advantage of the early-registration discount, if at all possible. To do so, send in your form to Lodestar no later than September 25.)

Our Forum program this year emphasizes what's happening in Washington regarding pension and retirement issues, including Social Security, as well as analyses of their impact on the stable value industry. Therefore, we are featuring well-known, high-level policy people on those topics, including association and think tank executives as well as economic and research professionals. Some of you may be familiar with Ed Hyman (Chairman, International Strategy and Development) and Milton Berlinski (Managing Director, Goldman Sachs & Co.) who are both confirmed speakers. In addition, the Special Half-Day Forum on October 27 promises to be especially stimulating, and will include several panels on alternative markets and products, both domestic and overseas (please see the back of the seperate flyer inserted in this newsletter for more specific information on this.)

Finally, as you read this issue of Stable Times, please bear in mind that all the valuable information it contains is provided through the time, talent, and hard work of our members. Your peers are the people who make possible the interesting and insightful articles that we enjoy reading every quarter (and we are always looking for new contributors and material!) And lest you doubt the value or the accuracy of the articles, I would direct your attention back to the June issue, where Allen Fen's prescient "Sex, Lies, and Performance Measurement" (p. 6) not only profiled performance measurement issues in our industry, but sounded an accurate if not eerie foreshadowing of the issue that was to become a national obsession in the debates about President Clinton's character. To quote Allen Fen: "Marriage and other personal relationships are built upon a foundation of trust, in theory at least, but in business, this isn't enough. Accountability is also needed . . . only with accountability is there credibility. Amen." The operative word here is "credibility." Certainly a value exhibited by our industry, as well as an issue for our times.

Looking forward to seeing you at the Forum in October,

John Milberg

Credit Risk in Synthetic GIC's

by Jacqueline Griffin, Diversified Financial Products

Introduction
Synthetic GICs gained rapid market acceptance in the early 1990s because they addressed plan sponsors' concern about insurance company credit exposure. Today, synthetic GICs represent nearly half of the stable value market.

As synthetic GIC product evolution continues — and as the synthetic portion of stable value funds grows — it is important to reexamine the investment principles that led to their development: financial credit risk and portfolio diversification.

This article examines credit risk differences between traditional and synthetic GIC products, and establishes a framework for quantifying synthetic wrapper credit exposure and determining appropriate exposure limits for synthetic wraps.

Credit Risk in Traditional vs. Synthetic GICs
In evaluating credit risk in traditional GICs, the primary consideration is the ability of the insurer to deliver its promised guarantee. The analysis is similar to that of corporate bonds. It focuses on the probability that interest payments will occur on a timely basis, and that the original principal will be redeemed on the scheduled maturity date. The main difference is that traditional GICs are essentially illiquid instruments, although they provide for benefit responsiveness to plan participants. Investment guidelines for GIC purchases typically impose constraints on issuer financial quality to minimize the risk of a credit event, while diversification standards are intended to reduce the magnitude of such loss by spreading the risk across a number of issuers.

In contrast, a synthetic GIC derives credit exposure primarily from the assets in the underlying portfolio, rather than from the wrap provider. This is because the underlying assets are owned explicitly by the plan. The synthetic wrap provider's product promise is centered solely on wrapping the difference between market and book values, not on guaranteeing the performance of the underlying securities.

A synthetic wrap agreement normally provides for book value accounting, benefit responsiveness, and a crediting-rate smoothing mechanism during the term of the contract. Wrap agreements, however, explicitly exclude defaulted securities from book value treatment. Therefore, the main credit risk a plan bears in a synthetic arrangement is the downgrade or default of the underlying assets. The potential default of a wrap provider is clearly a second-order risk.

While the probability of default of an issuer is the same for both a synthetic wrap contract and a traditional GIC, the magnitude of such loss in the event of a default is substantially less with the synthetic wrap. Because the plan retains ownership of the assets, it will always have the ability to liquidate assets at current market value to satisfy benefit requests, even though the wrapper may not be capable of providing book value advances to the plan.

Because the underlying assets retain their liquidity in the event of wrapper default, the *maximum potential loss* from a wrapper default is bounded by the difference between the market value of the assets and the wrapped book value of the portfolio. It is important to note that the potential market-to-book deficiency is an absolute upper bound on the plan's loss. As we will see, in most scenarios, the economic loss to a plan in the event of wrapper default is likely to be minimal.

Implications for Synthetic Wrapper Credit Exposure
Traditional GIC diversification policies in stable value funds vary widely, and might be as low as 5% for an average quality traditional GIC issuer, or as high as 25% for a superior quality issuer. In setting traditional GIC diversification guidelines, the plan implicitly establishes a ceiling on the maximum "dollars at risk" of exposure to any one issuer. Because the insurance company holds the assets supporting the GIC, and the plan has no access to these assets until maturity, dollars at risk from a traditional GIC perspective are defined by the amount of plan assets held by each insurer:

$$\textit{Dollars at Risk}_{GIC} = \textit{Book Value}$$

With a synthetic GIC, the plan retains ownership of the assets, and purchases a book value wrap. The wrap simply provides a book value guarantee around a notional amount of principal. Therefore, potential credit exposure to a wrap agreement is a fraction of the contract book value, and the plan's dollars at risk are limited, in the worst case scenario, to market-to-book value deficiencies:

$$\textit{Dollars at Risk}_{SYN} = \begin{cases} (1)\ \textit{Book Value - Market Value if Market} < \textit{Book} \\ (2)\ \textit{0 if Market} > \textit{Book} \end{cases}$$

A modeling technique (described below) to project future interest rate scenarios can assist plan sponsors in quantifying the magnitude of credit exposure associated with the wrap providers of the synthetic GICs in their stable value portfolio, and in translating this exposure into wrap provider exposure limits.

Building a Framework to Quantify Synthetic Wrap Exposure

To quantify potential synthetic wrap exposure, we must first estimate the maximum potential market-to-book differential over the life of the wrap, and then estimate the economic impact of such a differential. For our purposes here, we will use some simplifying assumptions to determine a worst-case wrap exposure within a 99% confidence interval for a typical plan. This approach will not provide a synthetic wrap exposure limit that will be appropriate for every plan, but it will provide a framework that could be customized to produce meaningful results for any plan.

Key to determining appropriate exposure guidelines for synthetic wrap providers is directly related to a plan's guidelines for traditional GIC carriers. Exposure will be defined as:

$$Exposure_{GIC} = \frac{Dollars\ at\ Risk_{GIC}}{Stable\ Value\ Fund\ Balance}$$

$$Exposure_{SYN} = \frac{Dollars\ at\ Risk_{SYN}}{Stable\ Value\ Fund\ Balance}$$

While exposure limits for traditional GIC issuers may range from 5%-25%, in this example we will constrain traditional GIC credit exposure to 5%.

Assuming current interest rates of 6%, interest rate volatility of 17%, and a 99% confidence interval, we can bound the change in interest rates over a 5-year time horizon to 500 basis points. Since a decrease in interest rates will increase the market value of portfolio assets, and therefore does not represent a risk from a credit perspective, we will examine only rising interest rate environments. If the 500 basis-point increase occurs uniformly over the time (100 basis points per year), and the synthetic crediting rate is reset annually, the market-to-book ratio over the 5-year time horizon is projected to fall to a minimum of 89%. In this example, the credit exposure associated with the synthetic wrap would be roughly one-tenth that of the traditional GIC (.56% vs. 5.00%):

Comparison of "Dollars at Risk"

Assumptions:

$100,000,000	Stable Value Fund Balance at Inception
5%	Traditional GIC Issuer Maximum (Issuer MaxGIC)
6%	GIC Rate; Initial Synthetic Rate; Stable Value Fund Blended Rate
17%	Interest Rate Volatility
4 yrs	Synthetic GIC Constant Asset Duration

	Stable Value Fund	*Traditional GIC*				*Synthetic GIC*			
Time	**Fund Balance**	**$ at Risk (BV)**	**Interest Rate**	**Crediting Rate**	**Market Value**	**Book Value**	**MV/BV Ratio**	**$ at Risk (BV - MV)**	**Exposure %**
0	$100,000,000	$5,000,000	6.00%	6.00%	$5,000,000	$5,000,000	100%	$0	0%
1	$106,000,000	$5,300,000	7.00%	6.02%	$5,100,000	$5,300,000	96%	**$200,000**	.19%
2	$112,360,000	$5,618,000	8.00%	6.26%	$5,253,040	$5,619,039	93%	**$366,039**	.33%
3	$119,101,600	$5,955,080	9.00%	6.68%	$5,463,120	$5,970,676	91%	**$507,566**	.43%
4	$126,247,696	$6,312,385	10.00%	7.24%	$5,736,276	$6,369,359	90%	**$633,083**	.50%
5	$133,822,558	**$6,691,128**	11.00%	7.92%	$6,080,453	$6,830,557	**89%**	**$750,104**	.56%

This example implies:

- It can be stated with a 99% confidence level that, even in a worst-case scenario, the synthetic GIC will have one-tenth of the potential dollars at risk as compared to the traditional GIC. $750,104 is the maximum economic loss the plan would incur based on the 89% market-to-book ratio *only if* it could not replace the wrap with another provider, *and* needed to liquidate all the assets immediately to make benefit payments. The economic exposure of a traditional GIC is nearly ten times as large, $6,691,128.

- While the economic exposure of the traditional GIC remains constant at 5%, the synthetic GIC exposure will fluctuate over time. In this example the synthetic GIC exposure increases from 0% at the contract inception to .56% five years later.

If a replacement wrap is not purchased but the assets are held to maturity, the plan may realize an immediate but temporary "loss" when it writes the book value down to the market value of the assets. Excepting defaulted securities, market-to-book discrepancies are purely temporary in nature, resulting solely from the inherent price volatility of the bond market. Ultimately the market-to-book loss will be recovered, as the assets will pay back face value at maturity.

Therefore, market-to-book differentials that are solely a result of interest rate volatility will produce no economic loss to the plan provided the securities are held to maturity, and the plan's liquidity needs for benefit payments can be satisfied elsewhere by other plan assets. However, temporary accounting losses are avoidable if a replacement wrap is purchased.

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The most conservative approach to measuring synthetic wrapper exposure would presume that, in the event of a wrapper default, the plan realizes any market-to-book deficiency and does not purchase a replacement wrap. The traditional GIC risk equivalent exposure can then be calculated for a synthetic wrap by multiplying the plan's issuer maximum for traditional GICs by the conversion factor that captures the ratio of exposure for a traditional GIC relative to a synthetic wrap for an equal investment commitment. Effectively, a plan that has a 5% exposure to a traditional GIC issuer and a 45% exposure to a synthetic GIC would be exposed to the same amount of credit risk.

Thus far we have assumed that a replacement wrap cannot be purchased in the event of wrapper default. In actuality, the wrap market today is well developed and highly liquid, making it unlikely that a plan would be unable to purchase a replacement wrap.

Taking a less conservative, but more realistic view that the probability of replacing a defaulted wrap at a similar price [Pr(Replacement)] is higher than 0%, the maximum portfolio allocation to a synthetic wrapper (Issuer Max_{SYN}), may increase to more than 100% of the aggregate stable value fund.

Measures of Risk Exposure and Their Relationship to One Another

Notation		*Resulting Calculation*		
Max Exposure$_{GIC}$ =	$\frac{\text{Max\$ at Risk}_{GIC}}{\text{Stable Value Fund Balance}}$	$\frac{\$6,691,128}{\$133,822,558}$	=	5.00%
Max Exposure$_{SYN}$ =	$\frac{\text{Max\$ at Risk}_{SYN}}{\text{Stable Value Fund Balance}}$	$\frac{\$750,104}{\$133,822,558}$	=	.56%
Conversion Factor =	$\frac{\text{Max Exposure}_{GIC}}{\text{Max Exposure}_{SYN}}$	$\frac{5.00\%}{.56\%}$	=	9
Risk Equivalency Exposure = Conversion Factor * Issure Max_{GIC}		9 * 5%	=	**45%**

Synthetic Issuer Maximums

Pr(Replacement) = Probability of replacing wrap at a comparable cost — i.e.. 0%, 50%, 75%, 95%

Issuer Max_{SYN} = $\frac{\text{Risk Equivalency Exposure}}{\text{1 - Pr(Replacement)}}$

45% = 45% / (1-0%)
OR
90% = 45% / (1-50%)
OR
900% = 45% / (1-95%)

If we assume that Pr(Replacement) is 50%, the Issuer Max_{SYN} increases to 90%. In this scenario—even if the wrap encompassed 100% of the stable value option—the economic exposure to the wrap provider would represent less than a 5% exposure to an insurer in the traditional guaranteed product context.

Additionally, our analysis has focused solely on market-to-book deficiencies. In the event of a wrap default, the market-to-book differential actually has an equal (50%) probability of being positive or negative. When market is greater than book, the plan experiences virtually zero hardship due to the default, and could possibly realize a net increase in value.

Conclusion

The economic exposure associated with default risk on traditional GICs is at least ten times greater than the exposure associated with synthetic wraps. The true credit exposure associated with synthetic GICs is minimal compared to traditional GICs.

Accordingly, the exposure guidelines used for traditional GICs are not an appropriate paradigm with which to view synthetic GIC issuer exposure. In fact, a plan that imposes arbitrarily tight diversification guidelines on synthetic GIC issuers may pay an inordinately high price for the presumed diversification benefits relative to the economic benefits.

"Why Stable Value" Presentation Now Available

Do you need to convince your Investment Committee that the stable value option really makes sense for your participants? Have you been asked to give a talk to a DC audience? Do you need materials for a client workshop? Rescue is as close as your Internet connection.

"Why Stable Value" is a readily downloadable presentation which Judy Markland has made available to the stable value industry at **www.lmstrategies.com**. You'll find text and hard copy versions of the presentation slides at the web site. If you contact Judy at **jmarkland@lmstrategies.com** or 781/860-7320, she will email you a Powerpoint file so that you can generate your own copies of the slides.

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The Hidden Cost of Buy-and-Hold (Part 2) The Fixed Income Universe and Duration Extension

by C. Jason Psome and Greg Wilensky, Sanford C. Bernstein & Co., Inc.

This article is the second in a series that explores the advantages of active fixed income investment management over a buy-and-hold approach. Our first article covered the advantages of maintaining an optimal maturity structure and the benefits of disposing of securities before they become cash equivalents. In this article, we will cover the following topics: (1) the ability to invest in securities from across the fixed income investment universe; (2) the ability to sell securities that are no longer attractive; and (3) the ability to extend the fund's duration.

A Wide Universe to Choose From

One of the main advantages of active management is the ability to select from a broad universe of investment securities. While there are over 6,000 issues, totaling approximately $5 trillion dollars, included in the Lehman Brothers Aggregate Bond Index, this is just the beginning. Numerous mortgage-backed, asset-backed, and corporate securities that active managers evaluate are *not* included in the index. It is estimated that an active manager can create an investment-grade portfolio from a universe of securities that exceeds $10 trillion dollars and covers more than 1100 issuers. In addition to this vast universe, opportunities are growing in the Eurodollar and non-dollar markets.

While the advent of buy-and-hold *synthetics* certainly increased the available universe in terms of issuers and market sectors, the number of securities appropriate for buy-and-hold synthetics is limited in comparison. Securities used normally have 4-6 years maturities at the time of purchase and generally do not contain embedded options that are likely to be exercised (i.e., well-protected PAC CMOs can be used, but not pass-throughs or companion CMOs). Securities are commonly limited to the corporate, MBS and ABS sectors. We estimate that the investment universe for a buy-and-hold stable value manager is about 2% of the active manager's universe.

Access to the active manager's much larger universe both lowers risk and increases potential returns. Issuer, industry, and sector concentration limits can be set much more conservatively for actively managed stable value accounts and funds. Two-percent issuer limits, which are common in an active portfolio, are more conservative than many buy-and-hold funds.

Furthermore, while risk reduction can normally be achieved only at the cost of lower expected returns, in this case, expected returns are higher. With a larger universe of securities from which to choose, the active manager is able to construct more efficient portfolios and is more likely to locate undervalued securities.

The Ability to Sell Securities Before Maturity

Like active managers, buy-and-hold managers purchase securities which are believed to be "cheap" relative to other investment alternatives. Active managers, however, regularly analyze every security in the portfolio to ensure that purchased securities are still attractive from a valuation standpoint. If a new security is expected to generate a higher return after accounting for transaction costs, bonds can easily be swapped within the portfolio. In contrast, most buy-and-hold managers continue to hold a security if it becomes fairly valued, or even "rich."

Additionally, some securities that appear attractive at the time of purchase lose their luster as time passes—perhaps the credit outlook deteriorates, or prepayment expectations change. In some cases, the active manager can sell the security even before the market reacts, thereby avoiding a loss or opportunity cost.

The active manager can sell securities to control or reduce portfolio risk. Portfolio duration can be managed to offset the impact of participant withdrawals in an actively managed portfolio. In a buy-and-hold portfolio, withdrawals from a cash buffer lengthen the portfolio's duration, while withdrawals from LIFO contracts shorten the portfolio's duration. In either case, with a buy-and-hold approach, the portfolio cannot be immediately re-balanced to the target duration.

Optimal Duration Targets for Stable Value Are Longer

With the advent of actively managed wrapped bond portfolios, the paradigm for determining the optimal duration of a stable value fund has been transformed. The fund's optimal duration can now be determined by weighing the trade-off between the higher expected return resulting from a longer duration target, and the superior interest rate tracking of a shorter target. Our research suggests that an intermediate target is optimal.

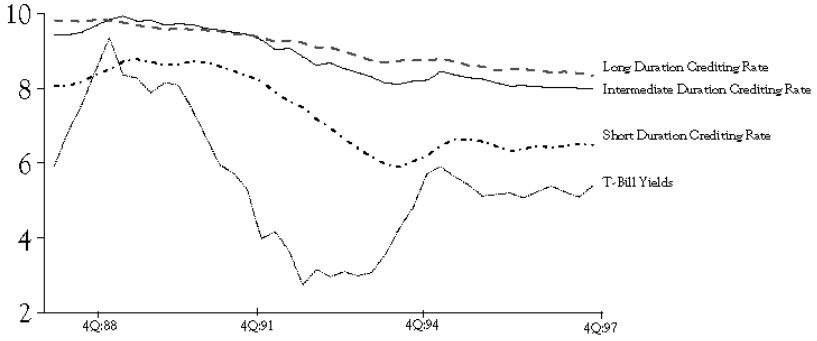
Historically, GICs have been managed to relatively short durations—typically 2–2 1/2 years. We believe that this was simply the outcome of the GIC selection process, rather than the result of a conscious trade-off between returns and rate-tracking ability. Laddering GICs out to five years creates a 2 1/2-year-duration GIC portfolio. A longer

duration can be achieved only by purchasing GICs with maturities in excess of five years. GIC managers and plan sponsors were concerned about longer GICs, because GICs, being illiquid, must be held to maturity. Five years seemed to be as much as most sponsors and managers were willing to tolerate. Bonds, on the other hand, are liquid. If a bond's credit outlook deteriorates, active fixed income managers do not have to wait for it to mature to get it out of the portfolio.

In researching optimal duration targets, we conducted a large number of historical simulations, covering the last 22 years, to assess the performance of different duration targets. Our goal was to find a target that produced a large average crediting-rate spread over money market rates (a typical participant benchmark), while minimizing both the frequency with which the crediting rate fell below money market rates, as well as the size of the shortfall in "worst case" scenarios.

Display 1 shows a simulation that covered 1988–97. The longer duration portfolios produced a clear advantage, generating both higher returns than other portfolios, and a positive spread over money market rates for the whole 10-year period. Of course, we noted that falling rates during this period certainly benefited longer portfolios.

Display 1 - The Impact of Duration on Retuns (1Q:88–4Q:97)



Source: Lehman Brothers, Federal Reserve Board and Bernstein estimates

Display 2 - Crediting Rate Below Money-Market Yields (1Q78-4Q97)

	Duration		
	Short (1.7 Years)	**Intermediate** (4.7 Years)	**Long** (9.6 Years)
■ Frequency	45%	38%	45%
■ Max. Deficit	(6.5)%	(6.8)%	(7.1)%

Source: Lehman Brothers, Federal Reserve Board and Bernstein estimates

Most people assume that, in a rising interest rate environment, a shorter portfolio would be best. Our research, however, shows that this would not have been the case historically (Display 2), when success is when success is measured as having a crediting rate lower than money market rates for the lest amount of time. In the "absolute worst" 10-year simulation (which covered the 1977–86 period), the crediting rate was below money market yields 40%, 38% and 45% of the time for short, intermediate and long duration portfolios respectively. Also, the magnitude of deficits (about 6.8% or so) was quite comparable at all durations. During this period, bond yields rose over 900 basis points, while money market rates climbed by over 1,200 basis points. What we found to be surprising was that, in this worst-case scenario, the shortest portfolio was no protection from a large shortfall relative to money market rates.

The simulations showed us that the frequency with which participants would have seen crediting rates below money market rates was not very different, regardless of duration. This is somewhat surprising, since the only way to *guarantee* not falling below money market rates is to be a money market fund. One might have expected, then, that the shortest portfolios we tested would have had the lowest frequency of sub-money market returns. Why was this not the case? The higher yields and average return of intermediate duration portfolios tends to keep their crediting rate higher—making up for the short portfolio's increased rate responsiveness.

Display 3 - Average Crediting Rate Premium Over Money-Market Yields

	Duration		
	Short (1.7 Years)	Intermediate (4.7 Years)	Long (9.6 Years)
■ Avg. 10-yr Period	2.0%	3.0%	3.1%

Source: Lehman Brothers, Federal Reserve Board and Bernstein estimates

The average annual premium over money market rates that participants would have earned ranged from 2% to 3% (Display 3).

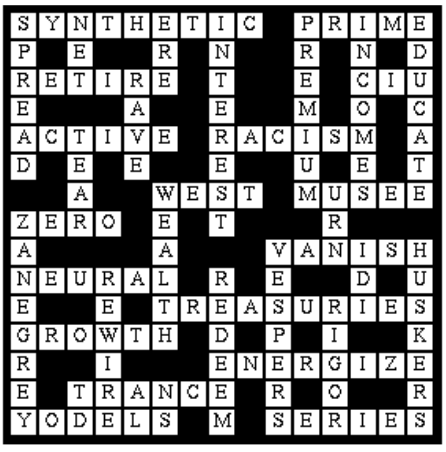
This is why stable value is attractive relative to money market funds—over time, there's a significant return pick-up moving away from cash. The main point, however, is that the average premium increased a full percentage point per year moving from the short to the intermediate portfolio, while extending out to a long duration provided very little additional benefit over the intermediate portfolio. In summary, the historical data clearly show that the intermediate portfolio was the best choice. However, there are other factors to consider in addition to historical performance. Cash flow can impact performance. To capture this factor, we re-ran our simulations with negative, positive, random, and worst case cash flow scenarios. Another factor is the divergence of market value and book value. We looked at how often market value could be below book value, and by how much. While participants see only book value, a plan sponsor has greater flexibility to make changes when market value and book value do not diverge greatly. Finally, history does not cover all possibilities, so we analyzed forward-looking scenarios based on our outlook for interest rate volatility, the expected return pick-up from extending duration, and employee contribution and withdrawal behavior.

Our duration target recommendations for stable value funds are as follows: A growing plan can afford to have a duration target in the four- to six-year area. This maximizes long term expected returns. The interest rate tracking is improved and the market-to-book fluctuations are dampened by the inflow of contributions in a growing plan. In the case of plans where the stable value growth is uncertain, a shorter duration (three to four years) may be preferable. Even in this case, the optimal duration is longer than that of conventional GIC funds. Of course, these recommendations are somewhat generic. Each plan has its own needs, and a duration target must be set in the context of the specific goals of the plan sponsor.

Nevertheless, simply choosing the duration that existed when stable value meant "just GICs" is not optimal.

Conclusion

Active stable value managers create portfolios from an investment universe substantially larger than the size of the relevant buy-and-hold universe. This improves safety and diversification while increasing the opportunity to purchase undervalued securities. By selling securities before maturity, an active manager can cash in on winning positions and close down losing positions early. The active manager also gains more control over the risk characteristics of the portfolio. Finally, instead of letting the credit concerns of GICs drive the choice of portfolio duration, the optimal duration targets for stable value can be selected in a risk/return framework. This framework shows that somewhat longer target durations are optimal. With active management, these targets can be met while reducing credit exposure to each issuer.



June 1998 Successful Puzzlers:

1) Jeff Mohrenweiser
CNA

2) Fiduciary Capital Management
Staff

INSURANCE INDUSTRY UPDATE First Quarter of 1998

by Allan G. Richmond, T. Rowe Price

- Surplus grew by 4.4% in the first quarter of 1998 versus 2.0% in the first quarter of 1997. Moreover, operating earnings rose by 3.8% over the prior year.

- The improvement in results was primarily attributable to a more favorable interest rate and equity market environment in 1998. During the first quarter of the year, one to ten year Treasuries declined by 10 basis points compared to a more than 50 basis point rise during the first three months of 1997. In addition, the DJIA and S&P 500 average increased by 12.1% and 13.7% during 1998 in contrast to only a 5.5% rise in both indices in 1997.

- The decline in interest rates and the robust stock market resulted in a dramatic increase in net realized and unrealized capital gains for both fixed income and equity securities. The modest drop in rates also enabled life companies to widen spreads on interest-sensitive life products, while the equity market gains fueled the continued growth in fees on separate account variable life and annuity products.

- The significant increase in surplus combined with the modest rise in operating income caused return on mean equity to decline from 9.6% in 1997 and an average of 9.3% over the 1990-1997 period to only 7.5% in 1998. Moreover, the growth in surplus resulted in a rise in the capital ratio — total surplus-to-invested assets — to 11.8%, up from 11.4% at 12/31/97 and more than 50% above the 7.3% level at 12/31/90. The ratio would have been even higher except for the decline in net investment yield to 7.41% in the first quarter, down from 7.60% in 1997 as a result of the decline in yields discussed above.

- The drop in Treasury yields following the economic turmoil in Asia and the need to credit competitive rates on interest-sensitive life and annuity contracts have caused life insurers to increase their high yield investments. According to the American Council of Life Insurance (ACLI), below investment grade private placements were 10% of the life industry's private placement investments in 1997, or about double the percentage during the 1991-1996 period. Assets allocated to the high yield 144A and high yield foreign currency private placement markets also surged in 1997, accounting for 8.1% of 144A investments and 14.3% of foreign private holdings versus 2.9% and 5.3% for 1996.

Surplus grew by 4.4% in the first quarter of 1998 versus 2.0% in the first quarter of 1997.

- Life insurers have also been slowly returning to commercial mortgages, with holdings in the first quarter of 1998 increasing for the second consecutive quarter. Moreover, commercial mortgage delinquency rates continued to decline, falling to 0.85% of the portfolio at 3/31/98 from 0.90% at 12/31/97 and 1.63% and 2.35% one and two years prior; restructured loans fell for the 13th straight quarter to 4.28% of the portfolio from 4.61% at 12/31/97 and 6.48% and 7.99% one and two years ago; and commercial foreclosures were about 70% below the 1997 level and more than 90% below foreclosures in 1992 and 1993, the height of the real estate downturn. The only negative in the sector was the higher delinquency rates in both the 1-4 family and agricultural sectors, which together account for only 8% of the total life companies'mortgage portfolio.

- From the end of the first quarter of 1998 through the latter part of June, the Treasury curve has flattened considerably, with spreads between one year and ten year Treasuries having declined from 24 basis points to between 5 and 10 basis points. Since many products, such as SPDAs, are supported by investments in the 5 to 10 year range while being credited with rates based on the one year rate, spreads have likely been narrowing on business repriced during this period. Therefore, it would not be surprising if operating gains in the second quarter of 1998 are below those for the first quarter, although the decline in rates will certainly have a favorable impact on net capital gains and, in turn, surplus growth.

Some of the figures in this report were obtained from (1) The Townsend and Schupp March 31, 1998 LIBRA Review and (2) the ACLI Mortgage Loan Portfolio Profile report as of March 31, 1998.

Proposed Legislation

continued from page 1

such as swap and repurchase agreements, securities lending arrangements, and forward purchase and sale agreements. Whether such contracts are used to increase returns on a portfolio or to help structure or hedge the risk involved in providing a wrapper, stable value participants are often concerned about the rights they have if a counterparty becomes insolvent. If anything can be learned from the Executive Life, Mutual Benefit, and Confederation Life debacles, it is that delays and uncertainty as to the status of one's position are unsettling to plan participants. In our opinion, the Netting Improvement Act takes a step in the right direction by alleviating some uncertainty.

Perhaps the most significant provision of the proposed legislation to stable value participants is the protections afforded whole loan mortgage repurchase agreements and securities contracts. Generally, under current law, there are two types of agreements/securities that are protected from the automatic stay and preference provisions of the Bankruptcy Code: 1) repurchase agreements whose underlying assets involve certain U.S. Government or agency securities; 2) securities contracts which involved securities. Therefore, if a stable value participant had entered into one of such agreements or contracts but with other types of underlying assets, on the bankruptcy of the counterparty, the stable value participant would not be entitled to terminate the agreement or contract, would possibly have to repay money received from such counterparty within the previous 90 days, and would not know for an extended time period whether or not the bankrupt counterparty would want to continue with the agreement or contract. Thus, even though whole loan mortgages provide greater return than more conventional assets, the increased bankruptcy risk may prevent stable value participants from considering them as an acceptable investment class. The proposed legislation, by affording the same bankruptcy protections to whole loan mortgages as to more conventional assets, could make whole loans an attractive investment category for stable value participants.

Another important modification in the proposed legislation is the prohibition of the receiver of an insolvent FDIC insured bank from "cherry picking" among contracts with a single counterparty, to select those it will continue to honor and those it will reject. Thus, if a bank providing a wrapper agreement to a plan also has entered into swap agreements or securities lending arrangements with such plan, the insolvent bank would not be able to choose to honor one or more swap agreements or securities loans and not honor the wrapper agreement.

The proposed legislation also amends the Securities Investor Protection Act of 1971 ("SIPA") which governs broker-dealer insolvencies. Currently the Securities Investor Protection Corporation can stay the rights of the counterparty to the broker-dealer to liquidate, terminate or accelerate financial contracts. It can also offset or net amounts under such contracts. As many stable value participants regularly transact with broker-dealers, the uncertainty created by a stay could be devastating. The Netting Improvement Act would amend SIPA to explicitly protect from any such stay the exercise of contractual rights to 1) liquidate, terminate or accelerate a securities contract, commodity contract, forward contract, repurchase agreement, swap agreement or master netting agreement; 2) offset or net termination values, payment amounts or other transfer obligations arising under one or more of such contracts or agreements; or 3) fore-close on any cash collateral pledged by the debtor brokerage firm in a transaction.

The Netting Improvement Act embodies a compromise recently reached between The Bond Market Association, the International Swaps and Derivatives Association and the President's Working Group on Financial Markets. The bill was unanimously approved by the House Banking Committee on August 5. It is currently being reviewed by other House committees and is expected to be passed by the House with certain technical revisions. Amendments to the Bankruptcy Code similar to those described above are contained in S.1914, the Business Bankruptcy Reform Act of 1998. The Senate bill does not include the related amendments to the banking and securities laws, however, and thus it is not entirely clear what legislation will ultimately be enacted.

For further information on the status of the Netting Improvement Act or the effect of the amendments contained therein, please contact Perry Shwachman at (312) 902-5661, Clint Uhlir at (312) 902-5491 or Marla Kreindler at (312) 902-5621 of the law firm of Katten Muchin & Zavis.

Stable Value Continues to Deliver Superior Risk-Adjusted Returns

by Janet Jasin Quarberg, Hueler Companies

While the stock marketís gyrations continue to capture the attention of the press and investors alike, stable value continues to quietly deliver superior long-term results. One commonly used index, The Hueler Analytics Stable Value Pooled Fund Index, outperformed both money market funds and a widely used benchmark of bond market performance over the 5-year period ending June 30.

As shown in Table 1, the Hueler Index has outperformed the IBC'S All-Taxable Institutional Money Fund Average by greater than 1.6% annually over the most recent five and ten year periods and has done so with less risk as measured by the variability of returns. In fact, the annualized standard deviation of returns for the Hueler Index was a mere .15% (15 basis points) for the last 5 years.

Fixed Income Investment Option Comparisons

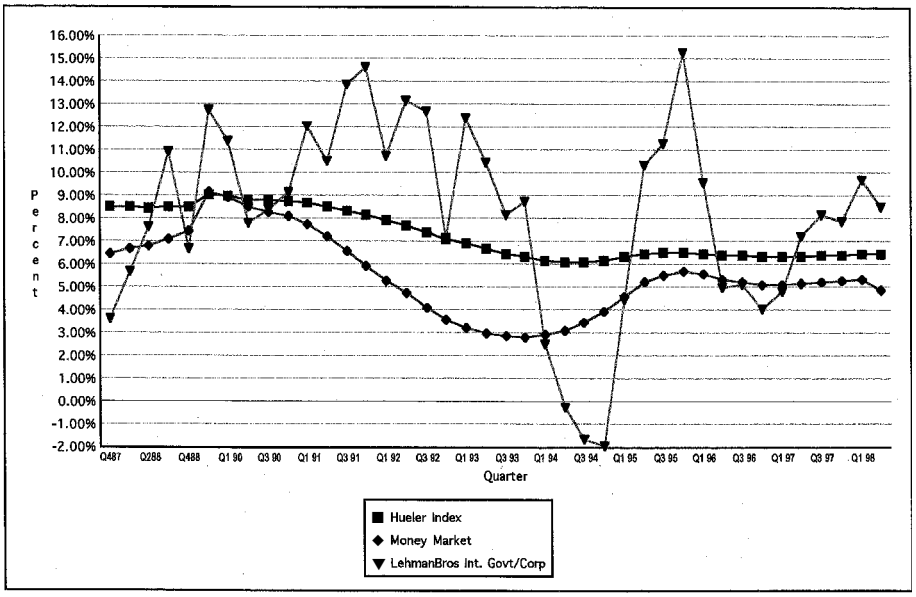


Table 1

	5 Yr. Annualized Performance	5 Yr. Standard Deviation	10 Yr. Annualized Performace	10 Yr. Standard Deviation
Hueler Index	6.36%	15 bpts	7.25%	114 bpts
Money Market	4.74%	93 bpts	5.58%	200 bpts
Lehman	6.11%	410 bpts	8.25%	375 bpts

Relative to the Lehman Brothers Intermediate Government/Corporate Bond Index, the Hueler universe has also fared well. Over the last five years, the Hueler Index has outperformed the Lehman Index by 25 basis points annually (6.36% versus 6.11%) with significantly less volatility. While the Lehman Index has outperformed the Hueler Index by 1.0% annually over the last ten years, the volatility of those returns have been more than three times that experienced by pooled funds, making stable value a superior risk-adjusted investment option.

This data validates why so many plan participants choose to invest in stable value when the option is offered. Stable value continues to provide participants with value added returns on both a real and risk adjusted basis.

Register Early to Get National Forum Discount!!!

Take advantage of the Early Bird Registration Discount on the SVIA National Forum in October by faxing or mailing your form and payment by September 25. You'll save $100! Make checks payable to SVIA and send registration form to Michele Sullivan, c/o Lodestar, fax number 818-832-1851. For questions, call Michele at 818-832-5591.

Deadline for Article Submission! November 1

If you're interested in submitting an article for the next addition of this newsletter, our editorial timetable calls for draft copy to be submitted by November 1. If you are interested, please call Allan Fen, Fidelity Investments, at (617)563-5651.

STABLE times

SVIA

Apples to Apples—Improving Stable Value Comparisons

by Ty Danco, Dwight Asset Management and Karl Tourville, Galliard Capital Management

The recent industry initiative to improve measures of comparing stable value portfolios (see articles by Dan Libby and Allan Fen in the previous issue of the Stable Value Times) is a welcome one. By and large, plan sponsors and consultants are in favor of the SVIA Performance Measurement Subcommittee's "white paper", and progress is being made in forging a consensus among stable value managers as to specific details. The effort is focused on finding an acceptable, simple and meaningful way to measure the investment decisions of stable value managers while eliminating the effects of cash flow distortions prevalent in book value measurements. The current proposal can be found on the Internet at www.dwight.com/new.htm.

While the subcommittee's effort is focused primarily on "economic value" return comparisons, in this piece we would like to highlight some (though certainly not all) reporting inconsistencies prevalent in the industry and where appropriate, suggest how to address them. It is our belief that standardizing certain portfolio reporting disclosures is a necessary addition to the work being completed on performance measurement and will lead to an increased understanding of a portfolios risk/return characteristics. For purposes here, the types of inconsistencies have been broken down into several primary categories; those relating to the reporting of key portfolio statistics; contract issues; and for lack of a better term miscellaneous items.

Portfolio Statistics

With the additional complexities that have arisen with the introduction of synthetic GICs to stable value portfolios, many of our standard practices should be updated, and perhaps a few discarded. Here are some of the bigger questions to ponder, coupled with our opinions/suggestions.

1. What is the credit quality of a single-A rated bond portfolio wrapped by a AAA/AA wrapper who does not guarantee against impaired assets? The answer to this one seems pretty straightforward. In the absence of a guarantee against impairment or default, the synthetics correct rating is single-A. If the higher contract issuer ratings are used as a measure of portfolio quality, at a minimum the weighted quality of the underlying assets should be footnoted.

2. How should Treasury/Agency securities be treated versus other AAA rated assets? Approximately half of all respondents to credit surveys equate the credit quality of Aaa/AAA bonds (e.g., credit card ABS) with that of U.S. government/agency issued securities. Other respondents make a distinction which gives higher credit scores to government/agency securities. For example, governments/agencies might merit an "11" on an otherwise 10 point scale, while other measures may score U.S. Treasuries a "12", agencies "11", and Aaa/AAA bonds a "10". From our perspective, the issue here seems to be less what version is used, but rather that there is consistency across the industry. If asked to pick one as most appropriate, we'd vote for the 11 point scale, with the proviso that the scale doesn't stop at 1 for Baa3/BBB- rated securities, but can continue into the negative point scores with non-investment grade (high yield) bonds. Additionally, credit scores should reflect composite rating agencies (Moody's/S&P) opinions given their frequent differences in opinions over the ratings of individual issuers.

3. How does one equate similar "safety" scores between liquid synthetics and illiquid GICs? This is a real puzzler and one that we don't have a ready made solution for. In the early era of stable value, where all investments were in comparable GICs, a credit score was the only distinguishing factor for safety. Now, however, a credit rating by itself can be misleading. For example, it is clear to us that an investment in a large, broadly diversified fixed income mutual fund with an average credit quality of, say, AA- does in fact have less overall risk than investing in a 5 year GIC with a similar—or perhaps even better—credit rating. There are however, others who would believe the opposite. Namely, that the GIC possessed credit quality equal to, or superior than, the synthetic. Consequently, lacking an ability to compare apples to apples, we suggest detailing separate credit ratings for synthetics vs. traditional GICs. In this case, the best policy would appear to be to increase awareness of the issue, and we encourage plan sponsors and consultants to not ask "What is the average credit quality of your portfolio", but rather "What is the average credit quality of your traditional GICs? Separate account GICs? Synthetic GICs? The liquidity provisions for each of these investments should also be considered.

4. Is weighted average maturity or duration a more meaningful measure of a portfolio's responsiveness to interest rates? No contest on this

one—it's duration. We hope that both individually managed portfolios as well as stable value collective funds start reporting duration instead of, or in addition to, weighted average maturity (WAM). It is important to note that neither measure addresses the equally important role of cash flow growth (both historical and expected) in a portfolio's ability to track rates.

5. There are several different measures of duration. Which is the best to use? In our view, effective duration is superior to modified duration in that it better projects an individual assets (or portfolio) change in price for a given change in interest rates. This is because it captures the effect of any leverage or optionality inherent in a security/structure (i.e. most MBS securities). The identification of a single preferred duration measure would also benefit plans using several outside managers, as each manager may be quoting duration statistics using different methods. We encourage the industry to adopt some appropriate option-adjusted duration measure to be used consistently and exclusively.

6. What duration should pooled funds be "held at" when a pool is used as a part of an individually managed stable value portfolio? The answer to this question is not as straightforward as it may seem. Since most pools are valued daily and pay participant-initiated withdrawals at book value, one could argue that the duration of the fund be considered as though it were a money market fund (near 0 years). Conversely, since a pool typically provides book value liquidity at the plan level with twelve months notice, a case could be made that the duration should be held at a year. Finally, one could simply carry the fund at its current duration measure (probably 2-3 years) since that would provide the best measure of its rate tracking responsiveness in most scenarios. Our opinion is that if the fund is used as a buffer, it should be held as either cash or at a one year duration. If it is considered a core holding, the funds current duration is probably most appropriate. If pressed for one answer for all cases for industry usage, we lean toward one year—assuming, that is, that the pool has a twelve month put.

Contract Issues

While there are a number of contract terms which are worthy of mention, we believe two critical ones involve whether a contract is participating or non-participating and the crediting rate methodology used. A couple of common pitfalls we see in this area are:

1. Assuming non-participating contracts are better than participating or hybrid contracts. Most stable value professionals put a higher value on non-par contracts than par that non-par is better than par, and the more non-par, the better. Simply stating this however, doesn't mean a thing if isn't put in the proper context. What is important to evaluate is the withdrawal procedures of a Plan, whether the contracts in line are above market or below market, or whether corridors apply, etc. It is easy to construct instances where a portfolios overall crediting rate would remain more stable (or even rise) with a withdrawal from a par contract rather than a non-par, even though that par contracts rate may change. A better measure to assess may be the impact on a portfolio's blended rate (or rate tracking capability) in the event of immediate withdrawals of 10%, 20%, 30%.

2. Not using a standardized crediting rate. Yields based on duration-weighted yields generally exceed those of the more common dollar-weighted yields. This distinction can be considerable in times of a positively sloped yield curve. What makes this a problem is that some crediting rate formulas use a dollar-weighted yield, and others use a duration-weighted yield, leading to different initial crediting rates on the same underlying portfolio. While ultimately these differences will converge, use of the same methodology would make comparing the crediting rate/return profiles of competing variable rate stable value instruments. Why can't wrappers all use the same crediting rate methodology?

Disclosure Potpourri

Highlighted below are a number of other issues worth mentioning

• **Comparisons vs. inappropriate benchmarks** Appropriate benchmarking should be done from the nearest benchmark, not the most advantageous one. As an example, 2.3 year duration book value portfolios are better compared to the Ryan 5 year GIC index (at 2.5 years, a 9% difference) rather than the Ryan 3 year GIC index (at 1.5 years, a 35% difference).

• **Hiding bad credits or defaults behind insurance company separate accounts**. The same principle holds true for separate account GICs as for synthetic wrappers. If, for instance, a defaulted issue is held in a participating separate account it should be disclosed. To not disclose may give a false impression of the strength of the underlying investments. To paraphrase another sort of sidclosure recently made - this might not technically be a lie, but continued silence is misleading and regrettable.

• **Truth in advertising.** Product providers should exercise care when publishing studies to insure that readers understand the assumptions used to

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Stable Value ... Sightings in the Press!

by Julie H Dennis, New York Life Insurance Company

More funds and more seminars to explain them may be leaving workers more dazed than empowered. But ignorance hasn't hurt in the booming stock market.

Surveys by Boston researchers Dalbar Inc. find many workers are challenged just to decode their 401(k) statements. The Financial Post special report "Why a portfolio benchmark" points out that a12% return tells us nothing about value. The emerging 401(k) advice industry argues that multifunds are a dead end because they tend to be limited to options for conservative, moderate, and aggressive investors. And finally the overwhelming evidence that the rise of 401(k)s requires workers to pony up not only money they need for retirement but more time and effort to fathom Wall Street's mysteries.

Financial Post May 16, 1998 The Financial Post Index-"Why a portfolio benchmark?" Last year your portfolio returned 12%. Is a 12% return good or bad? "Some say good when compared to a GIC." When we talk about asset mix, we are really talking about what percentage of the portfolio should be allocated to cash, fixed income and stocks. Too many investors spend too little time understanding the asset mix question".

Chicago Tribune July 14, 1998 What's Your Style? It Can Pay To Be Conservative In Retirement -Plan Investments. "If you are a chump for trusting the conventional wisdom, what with all the jitters about Japan's economic problems and ripple effects in U.S. markets."

On the Move... AIG to Purchase SunAmerica

On August 19, AIG agreed to buy SunAmerica for almost $81/share or $18 billion in stock. The combination of AIG and SunAmerica brings together two premier providers of financial services, each of whom is an active participant in the stable value market. In the stable value arena, SunAmerica has a GIC block of nearly $8 billion issued through it's flagship company SunAmerica Life and its AAA rated subsidiary SunAmerica National Life. AIG, through its subsidiary AIG Financial Products, has wrapped assets with a notional amount of approximately $6 billion.

Upon completion of the merger, which is expected by the end of this calendar year, SunAmerica will become a stand alone subsidiary of the AIG family of companies. Eli Broad, SunAmerica's Chairman, will remain with AIG, and SunAmerica will gain two seats on AIG's board of directors.

STABLE times

Checkout these articles and websites:

Los Angeles Times, August 15, 1998 "The Workers' Benefits Menu Debate"- Are employers in step with their employee needs?

Personal Business, August 3, 1998 "Do-It-Yourselfers Could Use Some Help"

The Financial Post, July 4, 1998 "Non -Residents Face Tax Issues"

Wall Street Journal June 9, 1998 "Failure To Diversify Could Prove Disastrous"

Wall Street Journal, May 14, 1998 "Bond Prices Climb On Support from Auction Of 10-Year Notes, Concern Over Troubles in Asia"

www.401(k)wire.com New Weekly Stable Value Column

www.denverpost.com Panel of experts discuss strategy for investors

To submit mentions of stable value (positive or negative) in the media or for assistance locating an article, contact Julie H Dennis, New York Life, Stable Value Group at (973)331-2595 or email julie_dennis@am.newyorklife.com

Apples to Apples

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reach their conclusions. As an example, when conducting return comparisons for different strategies (i.e. buy & hold versus managed) differences in key variables such as duration should be identified and adjusted for. Suffice to say, any and all fees should always be disclosed.

• **Sensitivity to interest rate movements**. "What would be the blended rate of the fund should rates rise or fall 100 basis points?" The concept is a good one, but the question as posed does not give a set methodology for coming up with the answer. Answering such a question can become an enormous modeling problem for portfolios heavily positioned in synthetics, and it's difficult to imagine that respondents will all use comparable methodologies to derive their answers. Simple steps in the right direction however, might include disclosing the percentage of mortgage backed securities held which fail the FFIEC test or reporting the portfolios convexity statistic, to name just a couple.

Our goals for raising these issues include better practices, better information, and eventually better decisions being made for stable value participants. While we don't have all the answers to the questions we have raised, we're sure that the readers can fill in some of the blanks—as well as make suggestions for other practices that need to be standardized or improved. We encourage responses and suggestions either to this magazine, Ty Danco (tdanco @dwight.com), Karl Tourville (karl.p.tourville@norwest.com) or to Klaus Shigley (kshigley@jhancock.com), who chairs the SVIA subcommittee on performance measurement. The Stable Value Times will publish whatever feedback received in the next issue.

GIC Issuers

continued from page 1

agreement issued by the carrier. The funding agreement is structured to meet the desired specifications of the investor, including the currency in which the structure will be payable. Any currency hedges, basis swaps, and interest rate swaps will usually be completed by the issuer and embedded into the funding agreement supporting the debt issuance.

Conclusion

Over the past twelve months, European demand for U.S. insurance company paper has increased at both the retail and institutional levels. As more and more issuers enter this market, the increased supply will have both positive and negative implications for this sector. On the one hand, an expansion in distribution should increase the market's understanding and knowledge of these product structures. However, increased competition may also result in wider spreads (and lower margins) if there is not a corresponding increase in demand. The combined impact of these factors remains to be seen. Another factor, which will undoubtedly have an effect on this market, is the upcoming European monetary union, which will create one currency and limit the potential arbitrage opportunities, which currently exist between the various Eurobond markets. Despite these factors, the international market may be attractive for those carriers willing to expend considerable time and financial resources in bringing their products to this market.

Simplified Product Structure