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Looking Back and Moving Forward

By Jim King



As 2015 draws to a close, so does my tenure as Chairman of the Board of the Stable Value Investment Association. It's been an eventful and exciting six years for me

serving on the Board and for the stable value industry as a whole. As I sat down to write my column this month, I thought it was an opportune time to look back on some of the challenges, opportunities and successes of the last few years.

As chairman from 2012–2015, I helped shepherd the SVIA through one of the most challenging and longest economic and regulatory cycles we've seen in years. I have been very fortunate to be supported by Gina Mitchell, President of the Association, who does most of the heavy lifting;

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Policy Maker Outlines Ideas for Improving Retirement Savings Plans

By Randy Myers

The modern defined contribution retirement savings plan—what most people today know as a 401(k)—is now three decades old. Its close cousins, 457 and 403(b) plans, have been around even longer.

We're still trying to get them right.

The problem? While Americans held approximately \$6.8 trillion in defined contribution plans at year-end 2014, according to the Investment Company Institute, studies consistently show that many Americans are not on track to a financially secure retirement. A report by the National Institute on Retirement Security indicates that about 40 percent of working households with members between the ages of 25 and 64 have no retirement savings.

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Consumer Interest Groups Back Proposed New Fiduciary Standards

By Randy Myers

Proposed new fiduciary rules from the U.S. Department of Labor have drawn mixed reviews from the retirement industry, but consumer watchdog groups are fans.

In April 2015, the DOL proposed expanding the definition of a fiduciary to effectively require anyone offering advice on or managing retirement accounts to act in the best interests of their clients. That standard already applies to registered investment advisors regulated by the Securities and Exchange Commission, but not to brokers regulated by the Financial Industry Regulatory Authority (FINRA) or insurance agents overseen by state insurance regulators. Brokers, for example, merely need to assure that an investment product is “suitable” for the client.

Many brokers have complained that the new rules would limit their ability to provide investment advice and services to retirement plans and their account holders. In a panel discussion at the 2015 SVIA Forum, representatives of two consumer groups largely discounted that idea and endorsed the DOL's proposal.

David Certner, legislative counsel and director of legislative policy for government affairs at AARP, observed that under current rules, a broker can approach a client with two investments that are relatively equal in value but recommend the one with higher fees as long as both are suitable for the client.

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Zach Gieske, Operations Analyst, who has brought the SVIA into the world of technology and social media; and a Board of Directors (including Chair-Elect Steve Kolocotronis, Nick Gage, Susan Graef, Aruna Hobbs, Helen Napoli and Marijn Smit) who tirelessly and passionately strive to promote and protect the asset class, educating and informing the influencers in the marketplace on the benefits of stable value.

Working together, we've successfully dealt with the challenge of finding and restoring capacity for stable value products—we've never been in better shape. In addition, we've demonstrated stable value funds' strength and resiliency in a continued low-rate environment while overcoming "stable value fatigue" stemming from the financial crisis. In the "challenges" column, we've also seen stable value funds become a litigation target, due in part to the 2006 ERISA amendments.

Regulators have been active on several fronts. As a result of the 2010 Dodd-Frank Act, the Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC) were tasked with determining whether stable value contracts should be subject to the same new regulations as financial swaps. The SVIA has worked diligently with the CFTC-SEC commission members and staff to educate them on stable value funds. This has included two responses to RFIs, including a second round of RFI once product definitions were defined, as well as several meetings with CFTC and SEC study team members, staff and commissioners.

During this same time period, the SVIA also needed to react to Department of Labor (DOL) actions that included new rulings on uniform disclosure of fees, expenses, turnover and benchmarks for all asset classes, as well as the ongoing debate over the expansion of fiduciary rules to cover all retirement assets, which fundamentally changes how all investment products are made available to DC plan sponsors/participants.

Additionally, there has been a sea change in the regulation of the conservative spectrum of DC investments. We have seen STIF reform by the OCC in 2012, and last year's final regulations on money market funds, which will become effective in October of 2016.

We also provided commentary to the National Association of Insurance Commissioners' (NAIC) separate account risk working group, advocating, along with several other financial industry organizations, for a principle-based approach to regulation of separate accounts, which the NAIC embraced.

Meanwhile, there continue to be areas of tremendous opportunity for stable value. The Government Accountability Office's (GAO) review of qualified default investment alternatives (QDIAs) and a recommendation that the DOL take a closer look at challenges plan sponsors and stakeholders are having with QDIAs could potentially lead the DOL to revisit the possibility of stable value as a QDIA option.

The past several years have also witnessed the rise of target-date funds and managed accounts, and we have

seen—and are actively working to promote—stable value's role in custom target-date funds and managed accounts. Another significant item was the Financial Accounting Standards Board's (FASB) simplification of disclosure requirements for employee benefit plans, which now recognizes and requires only contract value reporting for employee benefit plans that use stable value.

Specific to the SVIA, the past four years saw a strengthening of firms' commitment to the Association's goals and objectives. Members' commitment was demonstrated by:

- *The success we had in tackling a broad range of issues of import to the industry*
- *Increased attendance at SVIA Fall Forums and Spring Seminars*
- *Increased financial support of the Association in terms of dues, Value Program participation and reserves, which permit us to weather regulatory and economic challenges*

Last, but most certainly not least, a major goal of my tenure as chairman has been educating the public and industry about stable value. We have had some notable successes. There's been an abundance of positive press about stable value, including a publication from Bloomberg BNA in conjunction with the SVIA called A Guide to Stable Value Funds for Pension Plan Sponsors and Advisors and an article in Morningstar on stable value funds titled Tactics for Combating Low Bond Yields.

Along with the positive third-party press, we've had success promoting stable value on LinkedIn, Twitter, and the SVIA website, particularly through our stable value expert videos. Other successful education efforts have included:

- *The Stable Value Insiders' Views on Stable Value*
- *FAQs on guaranteed interest contracts*
- *FAQs on synthetic GICs*
- *FAQs on stable value basics*
- *Update of SVIA's glossary*
- *Redesign of the SVIA website: stablevalue.org*

Thank you to all of you who have helped to make the last six years so rewarding and stimulating. I look forward to seeing what the next six bring!

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Where they do, the median balance for households with workers approaching retirement age is just \$104,000.

Among those looking to improve this picture is Judith Mares, deputy assistant secretary for the Department of Labor's Employee Benefits Security Administration. In an address to the 2015 SVIA Fall Forum, Mares identified seven areas where regulators and retirement plan providers could make defined contribution plans work harder for plan participants:

Introduce and improve "decumulation" options. For decades, Mares said, the retirement industry has been focused on helping plan participants accumulate assets for retirement, with retirement plans developing sophisticated "accumulation menus" offering a wide range of investment options. Now, with the baby-boom generation beginning to retire, she said plans must develop sophisticated "decumulation menus" offering participants a variety of ways to convert retirement savings into a steady stream of income.

Promote keeping plan participants in their retirement plans after they stop working. "I'm not convinced participants value their plan," Mares said. "We know they value their [employer] match, because we spend a lot of time educating people to maximize it. But I'm not convinced everyone values that they can get a stable value fund in a defined contribution plan, and can't get that anywhere else—even though when you're living on a fixed income it's a tremendous asset to have that option. And I'm not sure participants value the institutional fee structure that comes with their plans." Mares said the retirement industry needs to mount a campaign to get plan participants to understand the full value of their retirement plans, including the value of having a plan fiduciary select and monitor investment options. At the same time, she said, plan sponsors should make sure the paperwork they give plan participants upon retirement doesn't encourage them to leave their plan.

Make it easier for participants to roll assets from a previous employer's plan into their current employer's plan. Keeping tabs on one plan is easier than keeping tabs on multiple plans, especially once it's time to start taking withdrawals. "Not all plans are designed for roll-ins," Mares said. "We indirectly nudge people out."

Make retirement plans more widely available. Despite the seeming ubiquity of defined contribution plans, only about half the U.S. population has access to one in the workplace, Mares said. Most who aren't covered are self-employed, work part-time, or work for small employers. "This is a systemic problem," she conceded. "If it was easy to solve, it would have been solved by now." Mares noted that a number of states have passed or are developing laws requiring employers to enroll their workers in a state-sponsored plan and facilitate their contributions via payroll deduction. Meanwhile, President Obama has directed the Department of Labor to look at how states can create plans that aren't preempted by the Employee Retirement Income Act and all of its regulations. "That guidance is in the works," she said, "although I can't talk about specifics."

Help Americans understand whether they are on track to have enough retirement savings. In 2013, the Department of Labor proposed requiring that retirement plan statements show participants not only how much is in their account but also what that amount would represent as an estimated lifetime stream of payments once they stop working. But before a federal agency does any rulemaking it must do a cost-benefit analysis, Mares said, and so far EBSA has not been able to document the benefits of showing account balances as a lifetime income stream. She encouraged SVIA members to research whether it prompts participants to save more. In the meantime, she noted, many participants already get some form of this information. A recent survey of 15 plan record-keepers found 14 already offering some form of lifetime income disclosure.

Promote greater use of annuities within defined contribution plans. Mares said that when she was working in the corporate world she championed making annuities available within retirement plans. She still does, but concedes that many sponsors haven't done it because they worry, among other things, that they will be on the hook as a fiduciary until the last dollar is paid out from an annuity. But Mares said there is a statute of limitations on a sponsor's fiduciary liability for selecting an annuity provider, and she encouraged plan sponsors to allow participants to directly annuitize some of their retirement assets while still in their plan.

Make it easier for unemployed workers to take loans from retirement savings plan. Retirement professionals routinely warn against withdrawing money from a retirement savings plan before retirement, but for plan participants who have lost their jobs a loan may make more financial sense than making an outright withdrawal that incurs taxes and penalties. While many plans don't allow participants who are unemployed to take loans from the plan, Mares said they should.

Mares acknowledged that what her audience most wanted to hear about—the DOL's proposed new fiduciary rules for anyone giving advice to retirement plans and IRA holders—was one where she couldn't offer much insight, given that the department has yet to publish final regulations. But she did offer that more than 5,500 written and verbal comments from the public made it clear that most people believe anyone touching a retiree's investment dollars should act in the retiree's best interest.

That said, she conceded the department also heard many concerns about the workability of the proposed rule changes, which in part is why it has included in them a "best interest contract exemption." Among other things, that exemption would allow entities such as broker-dealers and insurance agents to continue receiving compensation from third parties under carefully prescribed circumstances, and with substantial disclosures when doing so might present a conflict of interest. Mares also assured her audience that the department had heard their concerns about how that exemption might function, and is working on getting the logistics right.

Consumer Interest Groups Back Proposed New Fiduciary Standards

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"That's obviously a problem for the consumer," he said. "We need to do everything we can to make sure people are saving, and that those who do are getting good value and guidance for their money."

"Regulators shouldn't be setting minimum standards, and suitability is a minimum standard," agreed Micah Hauptman, financial services counsel for the Consumer Federation of America.

Certner singled out for special praise the DOL's proposal to extend fiduciary protections to IRAs, including rollover IRAs, which together now hold more assets than 401(k)s and other employer-sponsored defined contribution plans. He and Hauptman also said their organizations were generally supportive of the DOL's plan to include a "best interest contract" exemption in the new fiduciary standards. That exemption attempts to preserve commission-based compensation arrangements for fiduciaries advising retail investors and small retirement plans, while still ensuring that any advice given is in the best interest of the client.

While broadly supportive of the proposed rules, Hauptman cited two areas where he thought they should be amended before final adoption. One revolves around the best interest contract exemption. As proposed, it applies to small plans where investment decisions are not controlled by participants, but does not apply to small plans where, as is common in the 401(k) world, investment decisions are controlled by participants. Hauptman argued that the ex-

emption should apply to both types of plans. He also said the proposed rules should be clarified to make it clear that the exemption applies to advice on services, not just on products.

To be sure, not everybody is as happy with the proposed regulations as Certner and Hauptman. They were joined in their panel discussion by Don Trone, founder and CEO of 3ethos, and founder of the not-for-profit Foundation for Fiduciary Studies. Trone argued that "more rules and regulations will make it tougher for honest advisors to serve clients, and make it easier for dishonest advisors to hide behind the complexity of the rules."

Trone criticized the DOL's proposed new regulations for mentioning only one of what he said are a number of fiduciary best practices, and for taking a punitive rather than positive approach to encouraging ethical behavior. He also claimed that rules and regulations have never changed the moral and ethical conduct of people, and discounted the validity of a study by a White House Council of Economic Advisors concluding that conflicts of interest cost retirement savers about 1 percentage point in investment returns, or about \$17 billion annually.

Addressing Trone's comment about fiduciary best practices, attorney Michael Richman, a partner-elect with the law firm of Morgan Lewis Bockius, and also a member of the discussion panel, noted that he anticipates the DOL will issue final regulations in the Spring of 2016.

SVIA

Millennials' Financial Outlook Better than Advertised—At Least for Some

By Randy Myers

Conventional wisdom holds that young adults today face a dimmer financial future than their parents and grandparents. It's a sentiment exacerbated, certainly, by the financial crisis of 2008, the great recession that accompanied it, and the slow pace of economic recovery since then. In a recent survey by the Pew Research Center, the vast majority of older Americans said millennials—those born after 1980—face greater economic challenges than members of the three previous generations did when they were young.

In fact, the unemployment rate among millennials currently between the ages of 25 and 32 is higher, at 8.2 percent, than it was for all three previous generations when they were in that age group. But in an address at the SVIA 2015 Fall Forum, Richard Fry, senior researcher with the Pew Research Center, said the outlook for millennials may not be as bad as it looks, at least for those with a four-year college degree. And, he noted, the share of people with a four-year degree has been rising, with modest interruptions, for decades.

Still, about two-thirds of millennials don't have a college degree, and the difference in their earnings versus those who do is dramatic. In 2012 dollars the median annual income for college-educated individuals between the ages of 25 and 31 rose to \$45,500 in 2013, up from \$38,833 in 1965. For those with only a high school diploma, median income fell to

\$28,000 from \$31,384. "For the less educated, the bottom has fallen out," Fry said.

In considering how much millennials can save and spend, and what quality of life they can enjoy, Fry said it's important to look beyond their individual incomes and instead at household income. Here again, there's a stark contrast between those with college degrees and those with high school diplomas. Millennial households headed by someone with a college degree have income of about \$89,000 today versus \$72,000 for baby boomers when they were the same age. For millennial households headed by someone with only a high school diploma, income today has fallen to about \$40,000 versus \$50,000 for baby boomers.

Fry said several factors, beyond individual incomes, may help to explain why household income is so much higher for households headed by a college graduate. Those factors include marital status and the presence or absence of children in the home.

While today's young adults are delaying marriage more than their predecessors, the trend is especially true among those who didn't graduate from college.

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That means the head of a college-educated household is more likely to have a spouse contributing a second income. It's also more likely than in the past that the spouse will be college-educated, too.

Responding to a question from the audience, Fry said it's not clear to him that millennials are, as is so often reported, more risk-averse than previous generations, although he did concede that they are more reticent about taking on home ownership and a mortgage. They also tend to have less debt, other than student loan debt, than young adults

in the late 1990s and early 2000s.

Questions about millennial finances and attitudes are important because millennials account for a large and growing share of the U.S. population. Pew estimates that sometime this year they will surpass baby boomers as the largest living generation of Americans. There are about 75 million millennials today, and thanks to immigration their numbers are expected to continue growing for some time, peaking at about 81 million sometime in the 2030s.

SVIA

Fixed-Income Managers See Opportunities Despite Low Interest Rates

By Randy Myers

Despite extraordinarily low interest rates that would seem to have nowhere to go but up, some investment managers contend that fixed-income markets were offering some solid opportunities heading into 2016.

A key variable in that outlook is U.S. monetary policy. Ever since the Federal Reserve set the target for its benchmark federal funds rate near 0 percent seven years ago, investors have been speculating about when it would reverse that decision—and what the impact would be on the fixed-income markets.

They're still waiting for a definitive answer.

Heading into 2015, it was widely anticipated the Fed would raise the fed funds target soon—perhaps as early as June 2015. But as the U.S. economy continued to grow in fits and starts, and inflation remained well below the Fed's target for that metric, the Fed declined to take action. By mid-October, when the SVIA held its annual Fall Forum in Washington, D.C., it was no longer clear whether the Fed would act by the end of the year.

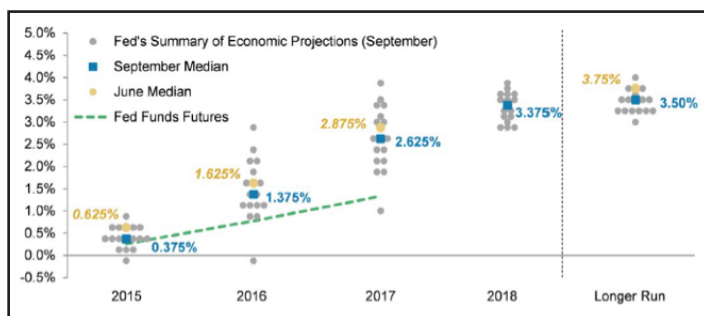
A key stumbling block for the Fed has been inflation. If it remains too far below the Fed's target of 2 percent, some Fed governors worry that raising short-term interest rates could jeopardize the economy's tenuous recovery. The Fed now doesn't expect inflation to hit 2 percent until 2018, and its members are all over the map on where they expect the fed funds rate to be leading up to that point. The highest forecast is 4 percent in 2017, and the lowest for that year is just 1 percent.

In a panel discussion of the interest-rate outlook during the SVIA 2015 Fall Forum, Erol Sonderegger, a principal at Galliard Capital Management, suggested that the Fed's wide-ranging expectations may be becoming counterproductive, damaging the Fed's credibility in terms of understanding where the economy is heading and contributing to volatility in the financial markets.

Robert Tipp, managing director, chief investment strategist and head of global bonds for Prudential Fixed Income, added that the Fed's decision not to hike short-term interest rates to that point may have reflected, to some degree, an "owning up" to the fact that it had been unduly optimistic about the economy's strength heading into the year.

Tipp said that as interest rates have moved lower rather than higher, more reasons have "piled up" for them to stay low. The U.S. economy is growing only moderately. The economies of Japan and Europe are "okay by their standards" but growing even more slowly. And Europe continues to face difficult economic problems, including very high unemployment rates. Meanwhile, Tipp said, the picture in many emerging markets is even worse. He shared a chart noting that China's growth rate has been falling for several years now, from 7.8 percent in 2012 to 7.4 percent last year. The chart also showed that Tipp expects China's economy to grow at only about a 5.4 percent rate this year—below the consensus view—and 5.2 percent in 2016. (This forecast preceded China's report in late October that its economy grew at only a 6.9 percent rate in the third quarter, its slowest pace since the global financial crisis.)

Dana Emery, president, CEO and a director of Dodge & Cox Funds, said she sees signs of improvement in the U.S. economy, with favorable developments in the housing market, in the number of household formations, in auto sales, and in declining energy prices that are helping consumers. While wage growth has been anemic despite declines in the unemployment rate, she added, improvements in the number of long-term unemployed suggest that wages might finally start to strengthen. Still, she observed, business spending has remained anemic lately, as has corporate revenue growth. Combining all that, Emery said she expects continued moderate economic growth in the U.S., with inflation eventually starting to pick up.



Source: Federal Reserve, Morgan Stanley

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Fixed-Income Managers See Opportunities Despite Low Interest Rates

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Even so, Steven Ruth, client portfolio manager for Voya Investment Management, said he doesn't foresee interest rates jumping sharply. "At some point, we'll have liftoff," he said. "But I think there are enough headwinds out there, and a lack of confidence in inflation going forward, that the Fed can keep rates lower for longer, and even when they make a move take a very slow, deliberate trajectory." As long as the Fed communicates that message and can deliver on it, Ruth added, it may be able to mitigate some of the volatility that rising rates would otherwise have on the financial markets.

In looking at how different sectors of the fixed-income markets might perform in this environment, Tipp argued that the outlook for fixed-income "looks very good."

The bulk of returns aren't likely to come in the form of capi-

tal gains, which would require rates to fall, but rather by taking advantage of the spread between yields on U.S. Treasury bonds and taxable bonds. While spreads are not as wide as they were during the 2008 financial crisis, he noted, they are quite wide relative to the level of yields, and that's made spread products attractive not just to U.S. investors but also to foreign investors. Foreign investors also are being drawn to the U.S. Treasury market, he added, because Treasuries are yielding far more than other sovereign bonds. Continued purchases of Treasuries by international investors could help to moderate longer-term Treasury yields, he said, even if the Fed starts to raise short-term rates.

Tipp, Emery and Sonderegger all emphasized the importance of doing sound credit research before buying any spread products, cautioning that the opportunities aren't equal across the marketplace. **SVIA**

Advisor to Global Leaders Sees U.S. in Throes of Political and Social Revolution

By Randy Myers

The deep partisan divide in Washington, D.C., may suggest to some that the country's future is not as bright as its past. Best-selling author and polling advisor Stanley Greenberg isn't among them. He contends the U.S. is poised for further greatness. But he does see the country being transformed by a series of revolutions whose cumulative impact, he argues, will be comparable to that of the Industrial Revolution.

Greenberg is a veteran pollster whose former clients include President Bill Clinton and Vice President Al Gore, British Prime Minister Tony Blair and late South African President Nelson Mandela. In October, he outlined his vision for the nation's future in a keynote speech at the SVIA's 2015 Fall Forum.

Highlighting themes from his latest book, *America Ascendant: A Revolutionary Nation's Path to Addressing Its Deepest Problems and Leading the 21st Century*, Greenberg said revolutionary changes in technology, energy, immigration and multiculturalism, along with a migration of Americans from the suburbs to the cities and the emergence of the millennials as the country's largest generation, are remaking the country in profound ways and laying the groundwork for continued world leadership—albeit with jarring implications for our political parties.

Greenberg identified the U.S. as the world leader in technology after investing an average 5 percent of its gross domestic product on research and development annually for the past 60 years. That's translated into success in the energy field, where new technologies like hydraulic fracking have dramatically boosted the nation's energy output and put the country on the path to energy independence. In fact, the U.S. Energy Department recently projected that the U.S. could be energy independent in as little as four years.

Against this backdrop, Greenberg said, the U.S. is undergoing an immigration revolution that is making the country both economically and culturally dynamic.

One in five of the world's emigrants winds up in the U.S., he said, with the result that New York City's population is now 37 percent foreign-born and California's is 40 percent, including half of Silicon Valley's engineers. In addition, he said, 70 percent of foreign-born Ph.D.'s stay in the U.S.

In this new multicultural United States, Greenberg said, 37 percent of the country's citizens are now racial minorities. Unlike other countries, Greenberg said, the U.S. is not going to war over these cultural changes, "but has arrived at a notion that we gain strength, and unity, out of our diversity—and that it is part of what makes us unique as a country." Specifically, he said, "If you ask college graduates, millennials, blacks, Latinos and Asians, 70 percent say that diversity makes America stronger—makes America better as a country."

The U.S. also is undergoing what Greenberg called a "metropolitan revolution" in which more and more Americans, especially millennials, are moving from the suburbs to the cities, reversing a trend that has persisted for 100 years. This has left the U.S. with 250 megacities in which, Greenberg said, innovative firms, immigrants, universities and research organizations tend to cluster. Two-thirds of millennials with a college degree have already moved to the country's 50 largest cities, he noted.

All this has created an America that is culturally exceptional and dynamic, and economically ascendant, Greenberg said. "It is virtually the only country that has a framework for dealing with its cultural diversity, and turning that into both economic and cultural value."

Which is not to say the country is without problems. Greenberg cited the struggles of single parents trying to raise children, often with little child-care help; jobs that don't pay well; stagnant incomes; disparities in pay between the average worker and CEOs; disparities in pay between women and men; and discomfort with the influence of special-interest money on politics.

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Advisor to Global Leaders Sees U.S. in Throes of Political and Social Revolution

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These revolutionary changes are disrupting the political landscape, Greenberg added, by giving birth to a multicultural “new American majority.” In the 2016 presidential election, he said, African Americans, Hispanics and Asian Americans will account for 28 percent of the electorate, up from 16 percent in 1992. In addition to these racial minorities, he said the new American majority also includes women and “seculars,” or non-religious Americans, with the latter now comprising a quarter of the electorate. Each of those groups—racial minorities, women and seculars—is growing, he said, and will account for a combined 63 percent of the electorate in 2016, up from about half in 2012. And, he noted, each votes two-to-one Democrat.

While much of the American public may be comfortable with these changes, Greenberg said the Republican party is engaged in a counter-revolution aimed at keeping the new American majority from governing. Since 2004 this counter-revolution has centered, he said, on waging a cultural

war to reengage evangelical voters and to nationalize every election. As a consequence, he said, the Republican base is now one-quarter GOP moderates, one-half evangelicals and one-quarter Tea Party voters. In general, he said, this base is opposed to Obamacare and same-sex marriage and deeply skeptical of climate change—issues on which the new American majority is more accepting. “This is a battle for American values,” he said.

Greenberg concluded that the country is at a tipping point politically. While 46 percent of American voters called themselves conservatives in 2008, today only 36 percent do. As a consequence, Greenberg said, there are formidable odds that the Democrat candidate for president will win in 2016, producing “a shattering election” for the Republican party. But he said the future course of events won’t be linear. Rather than dig in, he predicted, the GOP will “change dramatically” after 2016 in an attempt to fare better in future elections.

SVIA

Making Government Work: A Former Congressman's Plan to Revive American Democracy

By Randy Myers

To watch American elections is to watch democracy in action.

Or maybe not.

As former U.S. Congressman Mickey Edwards sees it, the United States has devolved to a point where the most extreme members of the two major political parties—not the public at large—control who can get elected. That’s not democracy, he argues, and he wants to change it.

The Oklahoma Republican knows the current system well, having served five terms in the U.S. House of Representatives between 1977 and 1993, including several years as a member of the House Republican leadership. Now a visiting lecturer at Princeton University’s Woodrow Wilson School, he was a guest speaker at the SVIA’s 2015 Fall Forum, where he outlined his case for overhauling the nation’s election system.

To see how the current system has gone awry, Edwards says, one need only look at a handful of recent elections in which popular politicians lost primary elections to extreme opposition candidates based on the votes of extraordinarily small slivers of the public. In Texas in 2012, for example, three-time Republican Lieutenant Governor David Dewhurst beat newcomer Ted Cruz in a primary race for the U.S. Senate by 12 percentage points, but lost to Cruz in a runoff election in which Cruz’s total votes represented just 2 percent of the Texas population. Two years earlier, Tea Party-backed long shot Christine O’Donnell had beaten nine-term U.S. Rep. Michael Castle in Delaware’s Republican Senate primary, despite receiving only 30,000 primary votes in a state of a million people.

Dewhurst could have run as an independent candidate against Cruz in the general election and likely would have

beaten him, Edwards said. And he’s convinced the popular Castle could have done the same against O’Donnell. But neither could try because of their states’ so-called sore-loser laws, which, like similar laws in 44 other states, prevent politicians who lose a primary race from being on the ballot in the general election. “Almost every place in America, we have a system in our elections that allows small, ideological subsets of the population decide who can even run,” Edwards said. “We have undercut the very basis of American democracy.”

Gerrymandering by both parties—manipulating the boundaries of an electoral constituency to favor one party or another—contributes to and perpetuates the problem, Edwards added.

There are signs of a backlash. In a 2013 Gallup poll, 42 percent of voters identified as independents. And Edwards notes that several states, including Arizona, Oregon, Texas and Ohio, are considering legislation that would do something like what Washington state has done: eliminate party primary elections so that everybody is on the same primary ballot. “In Washington state everyone who is running for the same office is on the same ballot: Republicans, Democrats, Libertarians, Greens, maybe three of this, two of that, whatever,” Edwards said. “You don’t choose to vote in primary A or primary B. You choose among every candidate for that office. If nobody gets over 50 percent, you have a runoff. It could even be two people from the same party. But if it’s two people from the same party they are no longer appealing to the far right or the far left because they have to appeal to the entire electorate.”

Edwards noted that California has adopted an approach similar to Washington’s, except for presidential contests, and said he’s hoping for more reforms.

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One area where Edwards distances himself from many others calling for election reform is in opposing term limits for members of Congress. "Term limits says having a lack of experience is a virtue," he said. "It also says we're going to take away from the voter the ability to choose. If you have somebody in Congress representing you and doing a good job, and serving the interests of your community, why should you be punished and be told you can't choose that person anymore?"

Edwards isn't particularly sympathetic to candidates running for president as political outsiders, either. "They're amateurs. If Ben Carson needed brain surgery, he would not go to an amateur," Edwards said, referencing the retired neurosurgeon seeking the Republican nomination for president. "Amateurism is not right in your business, and it's not right in trying to run a government of 320 million people with a huge army and nuclear weapons."

Edwards also is critical of the Supreme Court's Citizens United decision, which treats corporations as people under campaign finance law. Although he's in favor of money in politics—he said there should actually be more—Edwards is not a fan of having that spending power concentrated in the hands of the few. "Right now," he said, "less than 200 people are giving the overwhelming amount of money going into the primary system." He favors getting rid of campaign money from political parties, PACs, corporations and labor unions, while limiting individual contributions to a "reasonable amount."

"It's time we said we are a republic in form of government, but we are intended to be a democracy in the sense of the people choosing who will make decisions," Edwards said. "And we're going to have to make fundamental changes for that to happen."

SVIA

Advisors, Consultants, Sponsors and Defined Contribution Plans

By Randy Myers

If there's a relevant rallying cry for the retirement plan industry right now, it might be this: embrace change. That, at least, was the underlying message from Greg Jenkins, senior director with Invesco Advisors, Inc., in a talk at the SVIA's 2015 Fall Forum in October.

Jenkins, also chair of Invesco's Defined Contribution Institute, painted a picture of a retirement plan market that is changing in terms of who participates in it, how those participants are investing their money, and how plan sponsors and consultants are influencing their behavior.

It's a market changing in size, too. Although baby boomers have begun to retire and withdraw assets from their defined contribution retirement savings plans, Jenkins predicted that those plans will continue expanding thanks in part to an influx of millennials saving for retirement. He pointed to forecasts by McKinsey & Co. indicating that assets in defined contribution plans should grow from an estimated \$5.8 trillion in 2013 to \$7.7 trillion by 2018.

Changing investment strategies

As those millennials come to hold an increasingly bigger slice of retirement plan assets, the retirement industry can look for changes in how those assets are invested, too. Primarily, Jenkins seemed to suggest, it will be in target-date funds. "If you're a millennial, they [target-date funds] are all you've ever known," he observed. He cited data from Cerulli Associates indicating that about 40 percent of all new money flowing into larger defined contribution plans today is being allocated to target-date funds, and predicating that the proportion will reach 90 percent by 2019.

Among the key drivers of the target-date revolution are regulations issued under the Pension Protection Act of 2006, which granted qualified default alternative investment status to target-date funds. QDIA status affords fiduciary protections to plan sponsors who steer a plan participant into such an investment if the participant hasn't made an investment choice of their own. Meanwhile, Jenkins said, increas-

ingly popular plan features such as automatic enrollment and reenrollment of participants have boosted the number of participants who are being defaulted into QDIAs.

Target-date funds

This rise of target-date funds isn't all bad news for the stable value market. Jenkins noted that in large plans the use of custom target-date funds is growing at a 39 percent compound annual growth rate, and importantly, those custom funds can incorporate stable value funds as one of their components. Right now, 21 percent of large plan sponsors are using custom target-date funds, Jenkins said, and 25 percent are using collective trusts that don't belong to their record-keeper.

That said, there's no requirement that custom target-date funds include a stable value component, and not all plan sponsors and their consultants fully appreciate the benefits that stable value has to offer. Among consultants, Jenkins said, "very few have the time necessary to study stable value. When consultants have a client going through a search [for a stable value manager], or that has had a problem [with their stable value fund], that's when they dig into stable value."

Still, because plan sponsors rely heavily on consultants, Jenkins said it will be important for the stable value community to continue to educate consultants about their product. He also emphasized that those efforts should be directed not only at the research staff of consulting firms but also at their field consultants, who interact directly with plan sponsors. "You may update the researchers, but you can't assume that knowledge is flowing out to the field consultants," he said.

Money market funds

Jenkins noted that plan sponsors and consultants also are wrestling right now with upcoming regulatory changes for money market funds, the most direct competitor to stable value funds.

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Beginning in October 2016, money market funds that don't invest exclusively in U.S. Treasury bills will be able to impose redemption fees or temporarily suspend redemptions if their investment portfolios fall below prescribed liquidity thresholds. It's widely anticipated that some plans will balk at offering their participants money market funds that can't promise 100 percent liquidity, on demand, for participant withdrawals, and that some of those plans may opt to offer stable value funds instead. Others could switch to money market funds that invest only in U.S. government securities, which will be exempt from the redemption fees and gates. "We're expecting some movement to government money market funds," Jenkins said, "but otherwise we don't know what to expect."

Reenrollment

Jenkins cautioned stable value providers not to tiptoe around the issue of reenrollment, in which a sponsor enrolls or reenrolls all eligible employees into their plan, including those who may not have participated in the past. "The last thing you need to worry about is that you're putting the idea

in their head by bringing it up," he said. "Trust me, they're already hearing about it from their consultants. Every plan sponsor is aware of reenrollment."

In a typical reenrollment, plans default participants who don't make their own investment selections into a QDIA. It's not uncommon for that to significantly reduce the amount of money allocated to stable value. Jenkins cited two real-world examples. In the first case, stable value assets fell to \$45 million from \$180 million after reenrollment, then rebounded to \$55 million six months later. In the second, stable value assets fell to \$400 million from \$800 million, then rebounded to \$500 million six months later.

Given those sorts of numbers, Jenkins said it's important that stable value providers work with plan sponsors to manage the impact of reenrollments on their stable value funds. "There needs to be a lot of communication," he said. "Let them know you can do things to manage the impact, like carve out reenrollment of retirees if that's an issue. You also can make sure they understand that you need time to get your portfolio ready for reenrollment."

SVIA

Simplifying—and Selling—Stable Value

By Randy Myers

It's hard to maximize sales and market share when consumers don't fully understand or appreciate your brand—Imagine that automobile buyers didn't know that Ferraris are fast, that Jeeps are designed to take on rugged terrain or that a Lexus is likely to deliver above-average reliability.

This is something anyone in the stable value business can appreciate. According to a survey by Metropolitan Life Insurance, only 53 percent of plan sponsors know that stable value funds historically have generated higher returns than money market funds. Only 17 percent of plan sponsors, and only 22 percent of plan advisors, know that stable value returns historically have outpaced inflation. And only 37 percent of plan sponsors are very or somewhat familiar with new regulations that will take effect in October 2016 for money market funds, the most direct competitor to stable value funds.

These statistics prompted MetLife's Tom Schuster, vice president, stable value management, to convene four stable value colleagues in a panel at the SVIA's 2015 Fall Forum to discuss how the stable value industry could better promote its products.

The most popular idea? Make stable value simpler and easier for plan sponsors, plan consultants and plan participants to understand. When MetLife surveyed plan sponsors on why they don't offer stable value to their plan participants, 22 percent cited the complexity of the asset class and 11 percent said they weren't knowledgeable enough about it. "There appears to be a misperception about stable value that it's complex, and we need to change that perception if stable value is going to grow," Schuster said. "We need to simplify the asset class to expand the base for stable value."

Jeff Stein, a vice president and senior research analyst with Morgan Stanley, encouraged his colleagues to develop a short, easy-to-understand pitch, perhaps just a minute long, that shows what stable value has to offer and demonstrates the value it adds relative to money market funds. Asked whether it would be helpful to have independent research from academics comparing stable value to alternative investments, Stein said it would have to be distilled down to accessible talking points and should highlight the entire asset class rather than coming across as a product pitch.

Beyond simplifying the marketing pitch for stable value, some panel participants suggested it might help to simplify the product itself—by narrowing the definition of competing investments that require an equity wash provision in a retirement plan, for example, or by minimizing the types of plan changes that require the approval of stable value providers.

"If you can reduce complexity around the equity wash, it will help sell the product," said Tony Luna, head of stable asset management for T. Rowe Price Associates. He suggested the industry might limit the equity wash provision strictly to other products that have stable net asset values. "Some of the risks we're modeling don't make sense to buyers," he argued.

Warren Howe, MetLife's national sales director for stable value markets, said that as a wrap issuer he isn't terribly opposed to the idea of narrowing the definition of a competing fund for purposes of an equity wash. While it may have been fine to cast a wide net in the past, when the industry wasn't having trouble growing, he said, current market conditions argue for changes that will help grow the asset class. "It's a question of how narrow [we make the equity wash provision], where do we get to over time, and how many firms will be of the same mindset on the wrap side," he said.

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Panel participants also questioned whether it might make sense to minimize the number and type of corporate events that could expose stable value investors to potential account write-downs. They generally agreed that corporate-event provisions make sense, but the discussion prompted Howe to observe that the industry should be asking plan sponsors and advisors exactly what they mean when they say stable value is too complex. “We can put messages out there, but if we’re educating them on the wrong issues, we’re shooting blankly into the sky,” he said.

Regardless of any changes made to stable value products themselves, Luna suggested that the industry’s educational efforts should focus on consultants, since they control the industry’s access to so many plan sponsor clients. Howe added that it also could be helpful to target educational efforts at plan sponsors and participants, although he conceded that it may be more difficult to reach them, especially in the case of participants.

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Sequence of Returns Risk: Worse Than You Thought

By Randy Myers

The stock market downturn that stretched from late 2007 through early 2009 gave recent and soon-to-be retirees a harsh lesson in the dangers of sequence of returns risk. That’s the risk that poor investment returns at or near retirement age will devastate your portfolio and result in you outliving your savings. It makes a strong argument for including a sizeable chunk of conservative assets—things like annuities, perhaps, or stable value funds— in your portfolio at that stage of life.

But Dirk Cotton, a retired Fortune 500 executive and now an author, financial advisor and founder of the retirement blog The Retirement Café, says sequence of returns risk doesn’t just haunt those nearing or in retirement. It also impacts investors throughout the accumulation phase of retirement planning, albeit perhaps not as dramatically.

By way of example, Cotton sketched out two examples during a talk at the SVIA’s 2015 Fall Forum, one representing an investor adding \$12 to his \$100 portfolio each year and another withdrawing \$12 annually. For each example, he calculated the best and worst possible ending values knowing the annual returns for each of those five years but not the order of the returns. For the portfolio in which the investor was withdrawing money, the ending balance ranged from a high of \$48.49 to a low of \$34.92. For the portfolio getting \$12 in new contributions each year, the best finish was \$162.41 and the worst \$158.38.

Cotton pointed out that sequence of returns risk is most dangerous during the first 10 years of retirement because that is when retirement portfolios are largest—and because losses can compound for decades. The risk is smaller later in retirement because portfolios are smaller with less time for losses to compound. It also tends to be less dangerous in the accumulation phase of retirement investing, in part because, again, portfolios tend to be smaller then.

Individuals can largely eliminate sequence of returns risk, Cotton observed, by investing exclusively in conservative investments such as insurance contracts, inflation-protected securities such as TIPS, or annuities. That eliminates most downside risk but also a lot of upside potential, making it difficult to leave a legacy or simply to make sure your standard of living keeps pace with inflation.

Cotton suggested a more practical approach, which is to create a “floor” of retirement income with very conservative investments—supplementing any Social Security or pension income to which one might be entitled—and then invest any remaining assets in volatile investments such as stocks, bonds, commodities and real estate investment trusts.

While some academics argue that an income floor sufficient to cover fixed living expenses should make retirees comfortable allocating 100% of their remaining money to volatile assets, Cotton disagrees. He observed that in his own case, he would not have been happy if his volatile portfolio had fallen, say, 50 percent in value the first year after he stopped working. “After you retire you feel differently about it,” he said. “You need to dampen the volatility of your portfolio just to sleep at night.”

Cotton outlined a number of strategies that investors and retirees can follow, beyond the floor-and-upside approach described above, to mitigate the risk of outliving their assets.

Under one approach, retirees can withdraw a fixed percentage of their portfolio each year—4%, adjusted annually for inflation, is a common rule of thumb—rather than a fixed dollar amount. The downside is that their standard of living may fluctuate from year to year and they may end up, upon their impending death, with a lot of money that could have been used to raise their standard of living. “They might think, ‘Wow, I wish I’d spent more,’” he said.

Still, that’s probably better than running out of money before dying.

“As long as you don’t do that,” Cotton said, “you will have successfully funded retirement.”

SVIA

Stable Value: Overlooked Solution to Generating Retirement Income

By Randy Myers

Figuring out how best to convert retirement savings to a lifetime of retirement income has become the new holy grail of the retirement industry. Not coincidentally, it's also of vital interest to the tens of millions of baby boomers who have retired over the past few years or will likely do so in the next 15. It's a problem for which stable value funds could be at least part of the solution, says Elizabeth Heffernan, vice president, retirement services and consultant relations at Fidelity Investments.

Speaking at the 2015 SVIA Fall Forum, Heffernan said currently proposed solutions to the retirement income problem, at least for participants in defined contribution retirement savings plans, tend to fall into one of four camps:

- Out-of-plan guaranteed solutions, such as annuities funded with a lump-sum withdrawal from the plan and purchased independently by the retiree.
- Annuities as a plan distribution option, in which the plan sponsor selects an annuity provider for plan participants to use upon leaving the plan.
- In-plan annuities that allow participants to accumulate assets while they are working and then convert those assets into a guaranteed stream of lifetime income once they stop working.
- Other in-plan products that produce reliable and regular but not guaranteed income.

While retirement plan providers are exploring a wide range of solutions in all four categories, Heffernan said, they may

The Rise of Robo Advisors

By Randy Myers

In the nearly two decades since their debut, online investment advisory services have enjoyed modest success in convincing some investors to use them. Now they've got a sexy new name—"robo advisors"—and with it perhaps an improved chance of winning customers.

Much has changed since industry pioneers like mPower and Financial Engines starting providing online investment advice to retirement plan participants in the late 1990s. Practically an entire generation of millennials has grown up accustomed to getting information and conducting business via the Web. Now there are hundreds of automated advisory services offering to build and manage investment portfolios for them, often with no direct human intervention, for a fraction of the standard 1 percent of assets under management charged by most fee-based investment advisors.

"Most people still want human interaction, but there are absolutely people who have become so used to interacting through technology that we have to think about what it means for advice, not just in the next two years but in the next 10 years," says Sean Cuniff, investment management research leader for the Deloitte Center for Financial Services.

Speaking at the SVIA's 2015 Fall Forum, Cuniff argued that while robo advisors may not have the impact their creators anticipate, they will probably have a larger impact than a lot of senior executives in the wealth management industry are

be overlooking stable value funds in the fourth category. Stable value funds are already widely used in defined contribution plans and aren't burdened by some of the issues that have caused many plan sponsors to avoid in-plan annuities. Those include concerns about fiduciary liability associated with choosing an annuity provider, the perceived complexity of the product, and the challenges of unwinding the product if a sponsor decides it's no longer a good fit for their plan.

By using stable value funds to deliver some of their retirement income, Heffernan said, plan participants would enjoy a more reliable stream of income than they could get from many other types of investments.

Plan participants already make increasing use of stable value funds as they get older, Heffernan noted, and often continue to invest in them after retirement if plan rules don't make it difficult to stay in the plan. Plans sometimes push retirees out, she observed, by making no provisions for participants to take systematic or partial withdrawals after retirement.

Ideally, Heffernan said, retired plan participants should be able to take regularly scheduled withdrawals of either a specific dollar amount or a percentage of their account balance. They also should have the option to withdraw only their dividends and interest. Retirees also should have the option to request withdrawals on an ad hoc basis, she said, and to have withdrawals taken on a pro-rata basis across all their account holdings.

Heffernan's bottom-line message to plan sponsors and the retirement industry: "If you're looking for a retirement income solution, you already have stable value."

SVIA

expecting—although a lot of big wealth management firms are creating or refining robo advisors of their own.

Among other things, Cuniff said robo advisors may prove useful in helping financial services firms deal with the new fiduciary rules expected from the Department of Labor next year. As currently proposed, those rules would extend to broker-dealers a fiduciary duty to always act in the best interest of their clients, whether providing them with investment advice or selling them a product. Where conflicts of interest exist, the new rules would require financial services firms to rigorously disclose them.

One reason the DOL has proposed the new rules, Cuniff said, is a sense in government circles that the retirement services industry hasn't done enough to make sure that all Americans—not just those with sufficient money to hire a financial advisor—are financially prepared for retirement. One of the key advantages of delivering investment advice and portfolio management via a robo advisor, of course, is that it can be done far more cheaply than it can through a one-on-one relationship with a human advisor. Accordingly, robo advisors could help the financial services industry do a better job of reaching those who can't afford to work with a live advisor.

Financial services firms that aren't putting some thought and money into robo advisors, Cuniff concluded, "are probably going to miss the boat."

SVIA

“Follow the Yield” for Stable Value Rate of Return Expectation

By Phil Connor, MassMutual

When individuals are faced with a personal decision sometimes they'll resort to that familiar advice of “follow your instinct.” For stable value investments, a phrase such as “follow the yield” comes to mind when endeavoring to determine how the rate of return on the investment may trend over time.

Stable value investments appeal to retirement investors in defined contribution plans for their clear-cut expectations: a steady earnings rate on the amount invested and shielding of the account from market price fluctuations – such as those that occur with bond and stock funds – that may result in a reduction of the account's accumulated value. The stable value fund account value consistently rises based on the rate of return. While these characteristics are forthright, an investor ought to have a solid understanding of the drivers of the current return and expectations about the future direction of the stable value yield. The primary focus for this understanding is the yield on the assets that are being managed to support the stable value investment. Those assets could be managed collectively within a trust or in a single-plan portfolio, or in an insurance company contract structure (whether general account or separate account). Regardless of the structure, having insight about the yield those assets are generating provides a main clue to what an investor may expect with regard to the overall stable value investment rate of return.

The yield on underlying assets is the focal point as it is the starting place for determination of the stable value investment rate of return, meaning that stable value investors can broadly expect the rate will trend toward the underlying asset yield. Hence the notion to, “follow the yield” when gauging how the rate of return on a stable value investment may change over time. In participating stable value investments, where underlying investment performance is factored into the rate, the underlying yield is adjusted for an amortization factor to recognize the difference in the market value of those underlying assets relative to the stable value investment's book value (investor accumulated value based on the rate of return). This amortization, which means to spread out a financial impact over time, is designed to lessen the adjustment factor over time and allow the rate of return to become in synch with the underlying asset yield.

The main component of the adjustment factor is the difference in market value of underlying assets to book value, commonly referred to as the market-to-book value ratio. This ratio is broadly interpreted as a sign of soundness of a stable value investment, with a ratio greater than 100% indicating higher market value in support of the stable value investment. While it is an important factor in evaluating a stable value investment, and critical to understand factors like cash flow and asset performance that impact the ratio, it's normal to see fluctuations of the ratio in a range that include levels both below and above 100%. An evaluation that primarily emphasizes the ratio may obstruct recognizing the underlying asset yield as a key driver of whether the stable value rate of return will move higher or lower.

For instance, having a market-to-book ratio of 102% would generally be a favorable indicator of the stable value prod-

uct's health. It indicates underlying assets have appreciated at a higher rate than the corresponding book value, providing additional financial security. It also implies asset yields have moved lower (values and yields move in opposite direction) and the stable value investment is earning a rate of return that is above current market rates. In participating structures, the extra two percent of value is used to enhance the rate relative to the current underlying asset yield. Given this, the important revelation is the stable value rate of return will be expected to move lower over time, outside of changes in market conditions and any impact from significant cash flows (as well as outside of any minimum rate guarantees). If the current stable value rate of return is 2% and expected to move lower due to the yield environment, there is little to be excited about from an earnings viewpoint despite the comfort of having assets that are greater than book value.

Compare the above scenario to a situation where market interest rates rise and result in a market-to-book value ratio of 98%. In this case, the expectation for the stable value rate of return is that it will be trending up over time. Which scenario would the stable value investor prefer? All else being equal, an investor would seemingly be better off with the higher return expectation, especially if higher market rates are a response to higher inflation. The lower market-to-book ratio is amortized back to 100% over time in the stable value rate of return calculation and is a trade-off in the opportunity to earn a higher prospective return.

In the normal course of market performance, the market-to-book ratio of stable value investments will fluctuate. A level below 100% shouldn't be an all-in view of the soundness of the stable value investment; it is important however to recognize the factors influencing the level. In evaluating a stable value investment, it is a signal that underlying asset yields have gone up and that stable value investors stand to benefit from those higher yields over time. An underlying asset yield that is above the stable value investment's rate of return is a positive indicator of the future trend, which should be contemplated alongside the current level of market-to-book ratio for a more complete view of expectations surrounding the stable value investment.

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