

New Battle Over Reform Of Americans' 401(k)s

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Insurance companies and mutual-fund firms are locking horns over rules that will determine where millions of Americans' retirement money will be invested.

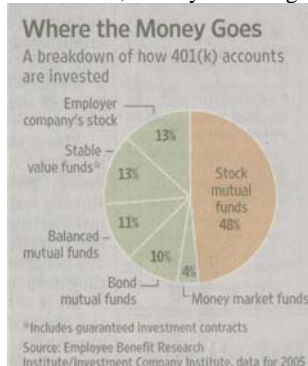
At issue: which types of investments should receive the government's blessing as appropriate for those participants in 401(k) retirement plans who decline to choose for themselves where to invest, leaving the matter to their employers.

Before Congress passed the Pension Protection Act last summer, employees who didn't opt otherwise routinely had their 401(k) money dumped into one of two safe-but-low-yielding options: money-market funds or insurance-based products known as stable value funds or guaranteed investment contracts.

To bolster retirement savings, the new law made it easier for companies to enroll employees in 401(k) plans automatically and to put their 401(k) money into potentially higher-yielding stock and bond funds.

Now the Labor Department is drafting rules to implement the law, prompting a lobbying donnybrook in Washington. The Labor Department has to decide which kinds of investments are appropriate defaults for employees who fail to choose from among various mutual funds and other options.

In September, the Labor Department proposed regulations that would discourage employers from putting all their employees' money into stable value funds and money-market funds. The department said default options needed to have a mix of investments, usually including stocks.



The proposed rule emphasized three types of appropriate default choices: balanced funds, which typically have an

unchanging mix of stocks and bonds; life-cycle funds, which have evolving asset allocations based on age; and a diversified portfolio of funds managed by an outside adviser.

The rules were supposed to have been made final in February, but protests from various interested parties, including the insurance industry, prompted the department to delay a final decision for another month or two.



Francis

"The stakes are very high," says Michael Francis, a Hartland, Wis., consultant who advises employers on how to run retirement plans. "We're moving rapidly toward a more automated environment for 401(k) plans...and a huge number of people are going to end up with the default investment option."

The insurance industry is lobbying for allowing employers to continue putting all of a worker's money into a single low-risk, low-return stable value fund.

Such funds are designed to protect an investor's money from losses and provide some additional income. They invest in a combination of bonds and specialized insurance contracts that carry guarantees against price declines. Fees are collected by the manager of the funds as well as the issuer of the contracts -- generally insurance companies.

Safe or Sorry

Stable value has been a popular default option for companies, mainly because they are so safe, minimizing the potential for lawsuits that might result from a more aggressive investment option going sour.

Estimates of how much money 401(k) investors have in stable value funds range widely -- from \$122 billion to nearly \$400 billion. The Stable Value Investment Association, which puts the figure at \$397 billion, says about one-third of that money is managed by insurance companies. About 27% of 401(k) plans surveyed by consultants Watson Wyatt Worldwide have a stable value as the default option.

While some money could shift out of stable value funds under the proposed rule, the fight is really over the expected influx of new 401(k) participants as more companies automatically enroll employees in such plans.

Participation in 401(k) plans could jump by 14 million people, up from 47 million today, according to the Investment Company Institute. Having failed to sign up for a 401(k) in the first place, most of those new participants are expected to end up in the default investment.

The American Council of Life Insurers told the Labor Department in a letter that the failure to grant stable value funds default status will "dramatically reduce, and possibly eliminate, their use in defined contribution plans." **MetLife Inc.** and other big insurers also have voiced objections to the proposed rule.

The insurers argue that it should be up to employers to decide the appropriate default options for their workers. For high-turnover work forces, the insurers say, stable value may be the best fit because departing workers might be tempted to pull their money out of a stock fund at an inopportune time.

Investors' Best Interest?

"Not every default investor is a long-term investor," the insurance council's letter said. Representatives of the council, including executives from MetLife and other insurers, have made their case directly to Labor Department officials. The council also visited with members of Congress and followed up with phone calls to key members "so that they knew it was an important issue," says Jack Dolan, a council spokesman.

In December, 18 members of Congress sent a letter to Labor Secretary Elaine Chao citing concerns similar to those voiced by the insurance industry.

The insurance industry's push surprised many in the fund industry, because they felt that the Pension Protection Act itself and the proposed rule had settled the issue. The Labor Department "got this right the first time," says Deborah Novotny, a vice president at T. Rowe Price Group Inc. who has been involved in the debate.

After the letter to Ms. Chao surfaced, however, the fund industry joined the lobbying fray.

Paul Schott Stevens, president of the Investment Company Institute and its chief lobbyist met with officials at the Employee Benefits Security Administration, the Labor Department agency responsible for the rule.

Some of the fund industry's biggest names also have joined the lobbying effort, including Vanguard Group, American Funds' adviser Capital Research & Management, Fidelity Investments, Barclays Global Investors and T. Rowe Price.

They argued that the insurance industry was trying to undercut the intent of legislation, which was aimed at getting investors' money out of lower-yielding funds. Default options should maximize retirement savings over the long term by focusing on higher-yielding stock and bond funds. They've backed up their arguments with data originally presented by the Stable Value Investment Association to depict healthy returns on stable value funds and instead showed that an investor owning stocks for 30 years would end up with 111% more money than an investor in a stable value fund.