

# Stable Value Market Review

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Many plan sponsors are concerned with the market value of their stable value portfolio in today's volatile market environment.

## Background

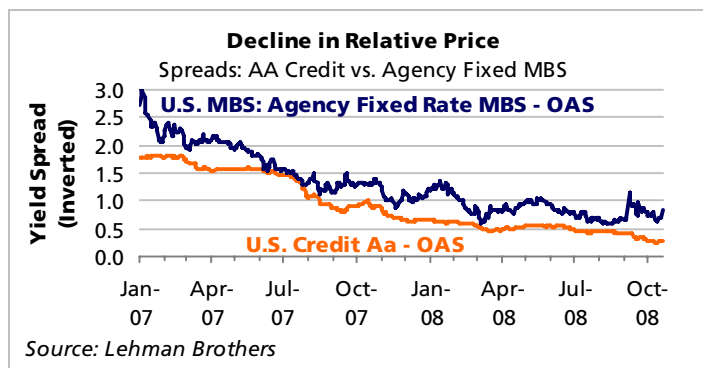
In recent years, mortgage brokers sold mortgage loans at the best rates in history. Then mortgage lenders packaged these loans into securities bought by hedge funds, banks, insurance companies and others. Americans and foreigners alike could not buy enough of these mortgage-backed securities because they seemed to offer high rates of return fully backed by the homes built by the U.S. housing industry. And bond rating agencies rated many of them "AAA," in effect, the *Good Housekeeping* Seal of Approval. Because of their attractive yields and perceived safety, many of these securities were held in stable value portfolios.

In part to respond to the demand, creative lenders offered loans based on low down payments or no down payments, low documentation loans, no documentation loans, even loans based on falsified incomes and assets. This creative financing led to "innovations" in the securities packages, producing an alphabet soup of investments like CDOs, CMOs, SPVs, and ABCPs, that were often confusing even to professional investors. And some professional investors followed the pattern set by the mortgage lenders: they bought the securities with low down payments and borrowed money to finance the rest of the purchase.

Later, a number of higher risk loans, known as "sub-prime," began to default. The credit crisis erupted when some hedge funds at brokerage firms collapsed after investors sought to withdraw their money. When hedge fund investors demanded cash, hedge funds had to sell bonds to raise the money. When they tried to sell questionable investments, no one wanted to buy them, and their values sank like stones in water. So they began selling the best, highly rated investments in large quantities, and their prices also collapsed. Other financial intermediaries, including deposit banks, investment banks, and insurance companies began to have similarly bad experience with the mortgage-backed securities in their own accounts. Suddenly, when everyone wanted cash and securities prices were falling, many banks stopped lending money at all to preserve their cash and protect their assets.

At the same time, as a by-product of the low interest rates, cheap money environment, the housing market became overbuilt, and with too many new houses on the market and others being foreclosed, the value of homes in many locations took a nosedive. Falling home prices, tighter credit, and overextended homeowners produced a predictable result: failure to make mortgage payments led to more foreclosures,

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more empty houses, and further price declines in homes and the pools which contained the mortgages. New home building slowed to a trickle as the available supply exceeded demand.

## Today

So how did this crisis spread to the portfolio of bonds that support the credited rates in your stable value contract? Stable value managers have always held mortgage-backed securities as well as corporate bonds issued directly by financial services companies. The credited rate on a stable value contract is based on the value of these securities as well as the interest payments that bond issuers make to bond owners. The interest yields on corporate and mortgage-backed securities are higher than those on Treasury bonds, and active management of the portfolio can produce additional returns to support credited rates. At ING, despite our efforts to construct diversified portfolios, we were not immune to the widespread problems. Mortgage-backed and corporate bonds make up about 70% of the total bond market. In a market where both mortgage-backed and corporate bond prices have fallen sharply, the value of these portfolios has been adversely affected.

Currently the relative values of corporate and mortgage bonds are as low as they have ever been.

## Outlook

Recently the Federal Reserve, the U.S. Treasury, and foreign governments have made concerted efforts to provide guarantees and inject money into the financial system to encourage a return to normal activity. There are hopeful signs that this coordinated rescue plan is beginning to work. While the portfolio has suffered based on its investment in these bonds, we believe it will also benefit when conditions improve. We do not believe that selling these securities at the fire sale prices offered today is in the best interests of plan participants. We will continue to actively manage the portfolio, and as global markets continue their convalescence, we will report our progress to you. ■