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DOL said to keep stable value off default option list

By Sara Hansard
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WASHINGTON — The Department of Labor has rejected a proposal by the insurance industry to include stable-value funds as a default option for 401(k) plans, according to industry sources.

The Labor Department on July 11 submitted to the Office of Management and Budget a proposal for the types of investments that may be used as default options in 401(k) plans. While both entities declined to discuss details of that proposal, sources say the DOL continues to exclude conservative stable-value insurance products.

The American Council of Life Insurers in March urged the OMB to block the Labor Department from finalizing a proposal made last September that would make life cycle funds, balanced funds and managed accounts the default options that employers could use without fear of liability for participants who didn't select their own investments.

"It's just downright illogical to exclude stable-value investments," said Jack Dolan, a spokesman for the Washington-based ACLI.

The Investment Company Institute, the mutual fund industry's powerful trade group in Washington, in May lobbied for the exclusion of stable-value funds, arguing that too many employers used the funds out of fear of being liable rather than because they are best for employees.

The Pension Protection Act, which was enacted last year, allows employers to enroll employees automatically in 401(k) plans unless workers specifically decline to participate. The law also directs the Labor Department to come up with default investments for people who don't choose their own.

The DOL is expected to issue final regulations on the matter next month.

Too conservative

The exclusion of stable-value funds is likely to be welcomed by many financial advisers. That's because many advisers contend that the low-yielding funds are not suitable for workers trying to amass substantial retirement savings.

"The challenge with the stable-value funds is, the investments are going to have

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Jim King: "Stable-value funds ... are going to have trouble keeping up with inflation," he says.

trouble keeping up with inflation," said Jim King, an adviser with Balasa Dinverno & Foltz LLC in Itasca, Ill.

Predictably, the life insurance industry has a different view of stable-value funds.

At the end of 2005, there was about $300 billion in stable-value funds, according to the ICI. The life insurance industry manages much of the money.

"There are innumerable scenarios under which [a stable-value fund] would be appropriate for an individual," Mr. Dolan said.

For example, such a fund might make sense for a worker in the midst of changing jobs, he said.

"It would be appropriate to put the money in a stable-value fund where it would be there on a temporary basis until they get their priorities established and [are] able to start addressing issues relating to long-term financial planning," Mr. Dolan added.

However, "401(k) plans are retirement plans. That's what they should be structured for … not for these side interests, like having the money in for a brief period of time," said Hal Schweiger, who is pension director at Capital Financial Advisors LLC in La Jolla, Calif.

Advisers wary

That said, some advisers are wary about removing stable-value funds and other conservative investment vehicles from the mix of default options.

"It's far from a cut-and-dried issue," said Gary Schatsky, president of ObjectiveAdvice.com in New York. "If we have any downturn, there's going to be quite the outcry if people find themselves defaulted into the equity market."

Employers who use equity options should be required to provide more education to participants, Mr. Schatsky said.

Other planners also see value in a stable-value-fund default option.

"Stable value is perfect for qualified plans in terms of taxation," said Morris Armstrong, sole proprietor of Armstrong Financial Strategies in Danbury, Conn.

It's better to use higher-return equity strategies outside a retirement plan to take advantage of lower capital gains tax rates, and use 401(k)s, which are taxed at higher ordinary-income tax rates, for more-conservative investments, he said.

Some argue that employers best know the needs of employees and should be allowed to choose what default investments are appropriate.

"Employers with older, high-turnover work forces, or in buyouts where plans are being merged and some people will lose jobs," could appropriately use stable-value defaults, said Lynn Dudley, vice president of retirement policy at the American Benefits Council in Washington.

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