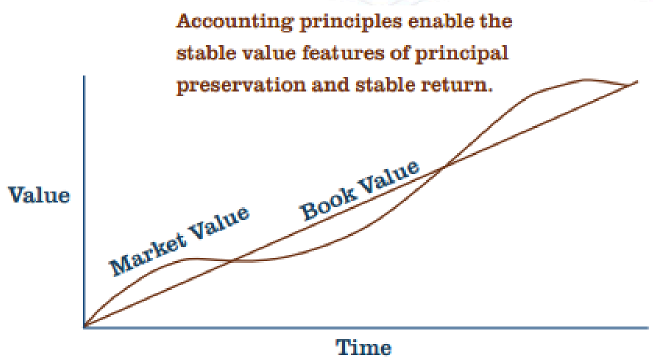
Introduction to Stable Value Funds

What is a stable value fund?

- Stable Value funds are capital preservation investment options, that are managed by investment managers and insurance companies.
- There are typically two components to a stable value fund; an investment portfolio (bonds) and an insurance contract (**wrap**).
- Stable value funds possess characteristics of both bond funds (yield) and money market funds (stable price).
- The combination of an investment portfolio and insurance contract allows for the use of **book value accounting**, a pricing convention that allows for a steady net asset value (NAV).

What is book value accounting?

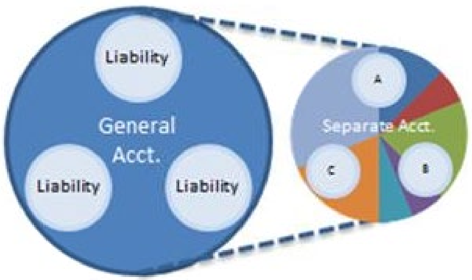
Book value accounting allows a participant's original investment to grow incrementally over time, without seeing the balance go down. This incremental growth is accomplished by periodically crediting the underlying portfolio's return to the participant's balance, regardless of the underlying portfolios market value. This periodic rate of return is known as the **crediting rate**.



Types of stable value funds

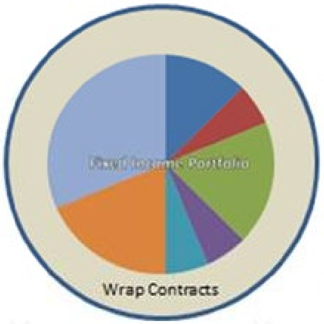
General Account GIC

- An insurance contract obligation to pay principal plus a crediting rate.
- Crediting rate set by a formula, a "spread" is often applied.
- Obligation to pay is backed by the general account of the insurance company in the case of insurer default (plan is a general creditor).



Separate Account GIC

- An insurance contract obligation to pay principal plus a crediting rate.
- The crediting rate is based on asset returns held in an insurance company separate account.
- Obligation to pay is backed by a separate account of the insurance company.

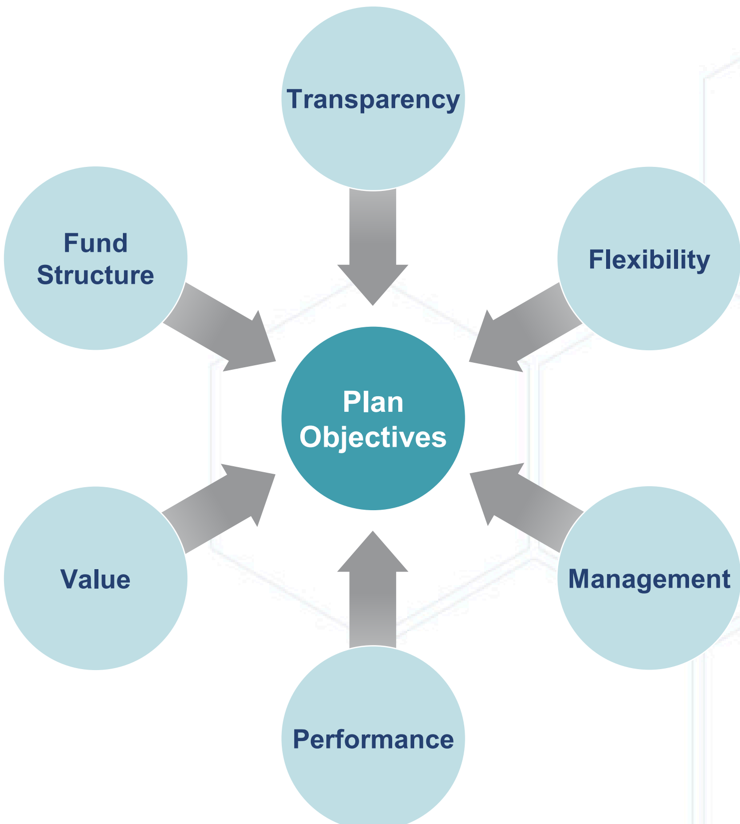


Synthetic GIC

- A portfolio, wrapped by multiple insurers, that guarantees principal plus a crediting rate.
- The crediting rate is based on asset returns held in a pooled fund.
- Obligation to pay is backed by the assets in the trust, which provides protection to investors in the case of an insurer default (plan can liquidate assets in the trust).

Evaluating Stable Value Funds

Selecting a stable value fund depends on a plan's objectives, and the sponsor's views on risk



Transparency	What are the contract provisions? Is there an underlying portfolio? How is the crediting rate determined?
Flexibility	How portable is the product? How restrictive are the put provisions and the equity wash provisions? What investment options do the investment managers consider to be a competing fund? How strictly is the put enforced?
Fund Structure	Are the underlying wrap providers and asset managers strategically allocated? How much unwrapped cash is in the portfolio? How is the underlying portfolio allocated?
Management	Do the managers and insurance providers have a tenured, successful track record? Is stable value a business to which the investment organization is committed?
Value	Does the product have a lean, transparent cost structure? Are insurance and asset management costs reasonable?
Performance	What is the crediting rate? What is the yield of the underlying portfolio?

Glossary

Book or Contract Value – For a stable value investment, the value of deposits, plus accumulated interest, minus withdrawals. Unlike market value, book value is not subject to market fluctuations.

Book Value Accounting – The method by which the valuation of a stable value investment is reported. Book Value isolates the plan from the volatility of market fluctuations cause by movements in interest rate or changes in credit ratings.

Competing Fund – Another investment option in addition to stable value within a defined contribution plan that offers relative principal stability, such as a money market or GIC fund.

Crediting Rate – The interest rate credited on the book value of a benefit responsive contract, expressed as an “effective annual yield.” As determined by the contract, the crediting rate may remain fixed for the term of the transaction or may be reset at predetermined intervals. Occasionally, the term crediting rate is applied to the annualized yield of a stable value fund.

Equity Wash – A provision in a stable value product that any transfers made from the stable value fund must be directed to an equity fund or short-term option of the plan for a stated period of time (usually 90 days) before the transferred funds may be directed to any other plan-provided competing fixed income fund (such as a money market fund). This provision is intended to reduce interest rate arbitrage by plan participants, thus permitting stable value contract issuers to underwrite the plan without excessive risk exposure.

Market Value – The amount an investment (bond, mortgage, stock or fund share) would be worth if it were sold at a specific time.

Put Provision – A put provision describes the ability of a plan to exit a stable value fund at contract value, generally subject to a waiting period.

Separate Account GIC – A separate account GIC is exactly like a traditional GIC, but instead of the participant falling into the general account of the insurance company, the participant has an exclusive account containing only that participant’s assets. In some circumstances, this allows the participant to better control the crediting rate and market-to-book ratio of the plan. Separate accounts are also considered greater bankrupt remote, meaning in the case of insurance company bankruptcy, a separate account GIC would theoretically have higher claim than traditional GIC participants.

Synthetic GIC – Instead of transferring assets to an insurance company, synthetic GICs are offered by investment companies. These contracts allow participants to retain possession of the assets in the GIC and pay the investment manager a fee. To retain the safety of assets, investment manager contract with insurance companies to “wrap” the assets, or insure them. While participants now pay fees to both the investment manager and the wrap provider(s), the participants also receive a crediting rate tied directly to their performance. In the traditional GIC, an insurance company may take assets, invest them, and make 5%, but only return 3% as it is the maximum rate of return specified in the contract. Participants in the synthetic GIC would not be limited to a fixed range of return with a synthetic GIC.

Synthetic Separate Account GIC – The synthetic separate account GIC is the same as a separate account GIC, except is uses the synthetic structure: participants own assets, the plan is administered by an investment manager, and the assets are wrapped by insurance companies.

Traditional (or General Account) GIC – An insurance contract issued by an insurance company that guarantees a rate of return, often between some range of values (e.g. between 1% and 3% per year), in return for an investment in the product. When a participant enters a traditional GIC, the assets are owned by the insurance company and the guaranteed rate of return is provided to the participant. When a participant decides to leave, the principal is returned as well. In the event of bankruptcy, all participants in the traditional GIC have the same level of claim on the remaining assets.

Wrap Contract – An insurance contract that ensures that participants can transact at book value on a daily basis (also known as being benefit responsive).