



## **STABLE VALUE WHITE PAPER**

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# **TABLE OF CONTENTS**

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- 03.** Introduction
- 04.** Background
- 06.** How Stable Value Funds Work
- 07.** Two Main Types of Stable Value Products:  
Insurance Company General Account and “Pooled” Funds
- 11.** More About Stable Value Fees: Where’s My Expense Ratio?
- 12.** Two Main Types of Stable Value Products:  
Ins. Company General Account vs. Commingle/Pooled Product
- 15.** Key Questions for Evaluating a Stable Value Fund
- 16.** Things Good Advisors Are Aware Of
- 18.** Where to Get More Information
- 19.** Best Practices for Advisors
- 20.** Dealing with Put Provisions
- 21.** Synopsis
- 22.** SV Glossary/Definitions

## INTRODUCTION

Stable Value (SV) is an important asset class in the defined contribution marketplace as measured by participant usage and percent of total DC assets. Despite its importance though, SV funds are still not well understood by most advisors and their clients. This paper is written specifically for ERISA fiduciary advisors and is intended to give a basic overview of different types of stable value products, how to evaluate their key features and what to look out for so a fiduciary advisor can feel confident making specific, due diligent recommendations about stable value products to their clients.

For purposes of this paper, we divide stable value products into a simple two part world: (1) Insurance company general accounts (GA) where the book value protection is provided by the full faith and credit of a particular insurance company and (2) Synthetic GICs or “pooled” products where a stable value investment manager runs an intermediate-term bond portfolio and the book value protection is provided by “wrap” providers. Although we cover these basic structures later in the paper, I mention this at the outset because there are other types of stable value products like insurance company separate accounts that are generally not available to smaller plans or products that blend the above distinction. For example, a pooled Collective Investment Trust (CIT) product that buys insurance company GICs for wrap protection. By focusing exclusively on our simplistic two-part world of insurance company general accounts and CIT pooled products, not only do we learn a lot about stable value, but we also deal with a large percentage of available product.

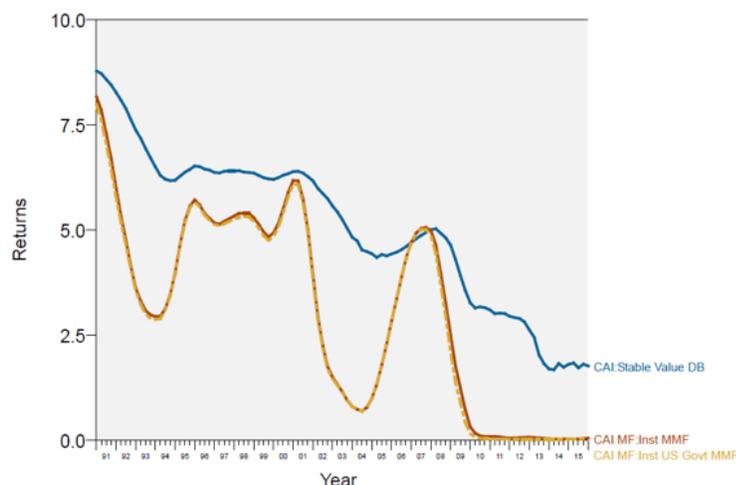
## BACKGROUND

Let's start with some basic facts. First, stable value is an important asset class currently representing about 11.7% of the \$7 trillion in total DC assets. According to Callan's DC Index, more than 60% of the 100-plus largest defined contribution plans tracked use stable value funds. Additional facts from EBRI include:

- From 2007- 2015, stable value has ranged between 6% - 15% of total 401(k) plan assets. (Note: Prior to this time period, stable value assets were even higher.)
- The average allocation to stable value ranges across different participant salary bands from 11% - 13.8%.
- SV is found in about 50% of all 401(k) plans.
- For EEs older than age 50, stable value as a percent of total account balance is 13.3% and for EEs older than 60, the number jumps to 20.2%.

From a participant perspective, stable value, like a money market fund, is considered a "safe" option inside of a plan. It provides a modest return and rarely, if ever, loses money because wrap providers, or the insurance company, protect the participant book value. But the differences end there. Historically, stable value has generated a much higher rate of return than money market. According to data from Callan, over the past 25 years, stable value funds have generated higher returns than money market funds for all but one brief period of time before the 2008 financial crisis. (Please see the time chart below.)

Rolling 4 Quarter Returns  
For 25 Years Ended  
December 31, 2015



Taking advantage of this historical risk/reward premium advantage, good fiduciary advisors have included stable value in their clients' portfolios for many years. And more recently, some advisors are intentionally re-designing their clients' retirement plans to encourage retirees to keep some/all of their retirement savings in the plan in order to maintain access to stable value as well as to take advantage of lower, institutionally-priced investments. Because stable value funds are only available in ERISA plans (i.e., they are not available in the "retail" marketplace), retirees can continue to keep access to a "safe" investment option that has historically outperformed money market funds or bank CD products.

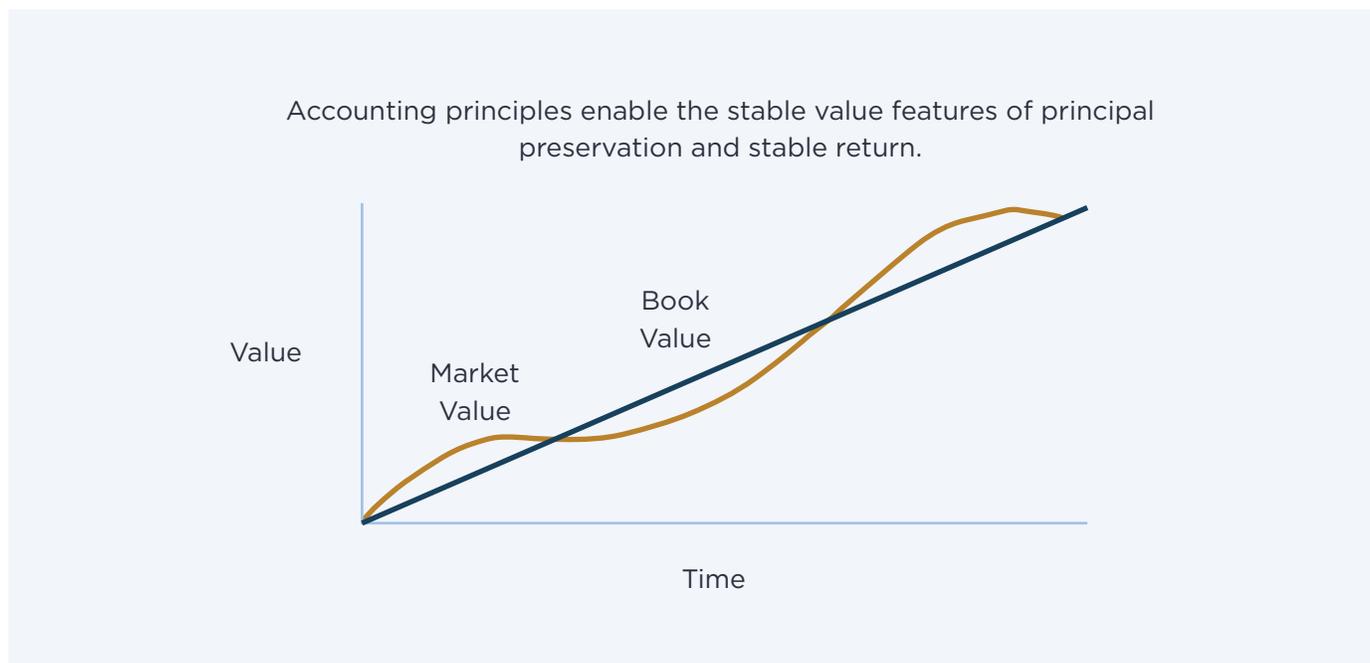
Whatever your reason for using stable value, few advisors spend much time analyzing the product. Typically, they recommend either the recordkeeper's proprietary fund or, if there is the ability to choose among several competing stable fund products, they rely solely on the crediting rate to determine which product to recommend. In today's post-DOL Fiduciary Rule world, this lack of due diligence and procedural process is no longer acceptable. Given the new world, most advisors working in the ERISA marketplace today act in a fiduciary capacity, which not only means making recommendations in the best interests of clients, but the need to demonstrate proper due diligence.

The upshot is that conducting due diligence on stable value is now a basic requirement because not doing so puts clients at risk and places the advisor at a disadvantage relative to their competition. Furthermore, stable value products cannot be properly analyzed by just looking at a single data point such as crediting rate or a market-to-book ratio, as important as these two data points are. Stable value products vary significantly in terms of basic design, portfolio holdings, contract details and discontinuance options and it's critical that fiduciary advisors understand all of these details so they can help their clients understand exactly what they are buying. The good news is that new sources of detailed stable value information are now available to advisors allowing them to quickly understand a specific product's strengths and weaknesses and to compare it against other types of products.

## HOW STABLE VALUE FUNDS WORK

We now turn our attention to a basic overview of stable value products. The rest of this paper explains how stable value funds work, their two most basic types of architecture, how to evaluate them and where to locate good, objective detailed information about various products and how to compare them against one another.

Stable value funds possess characteristics of both bond funds and moneymarket funds, but they do not fit neatly into either of these asset classes. Stable value funds generally invest in a portfolio of high-quality bond funds that usually have a duration (i.e. a measure of a fund's sensitivity to changing interest rates) of approximately 2 - 4 years. This longer duration generally enables stable value products to deliver better returns than a money market fund which typically invest in short-term securities that mature in less than 6 months. Like money market funds, SV funds seek to maintain a constant \$1 share price, or net asset value (NAV). To maintain the constant \$1 NAV, the funds' managers use "book value accounting" (see graphic below) which "smooths" any difference between a fund's market value and its book value over time. As mentioned earlier, stable value funds are available only in ERISA retirement plans. The underlying investment portfolio consists of a mix of diversified, high-quality, fixed income securities and are offered by both large investment firms with an expertise in fixed income management, as well as by insurance companies whose balance sheet assets are invested primarily in fixed income securities.



<sup>3</sup>The Real Value of Reputation by Charles J. Fombrun and Jonathan Low <https://www.iabc.com/wp-content/uploads/2014/10/The-Real-Value-of-Reputation.pdf>

<sup>4</sup>The 2017 US Reputation Dividend Report [http://reputationdividend.com/files/9415/0048/5298/US\\_2017\\_Reputation\\_Dividend\\_Report.pdf](http://reputationdividend.com/files/9415/0048/5298/US_2017_Reputation_Dividend_Report.pdf)

Investments in stable value funds are not insured by the FDIC, the Federal Reserve Bank, the fund managers, or the recordkeeper of the retirement plan. Depending on the product type, a stable value product's "book" value - the value of a participant's account including contributions and interest - is protected against loss of principal by either an insurance contract known as a "wrapper" or is backed by the general account of the insurance company offering the product. Although unlikely, it is possible to lose money by investing in a stable value fund. As a plan advisor, knowing how to identify a "good" stable value product can help to dramatically minimize the chance for loss.

## TWO MAIN TYPES OF STABLE VALUE PRODUCTS: Insurance Company General Account and “Pooled” Funds

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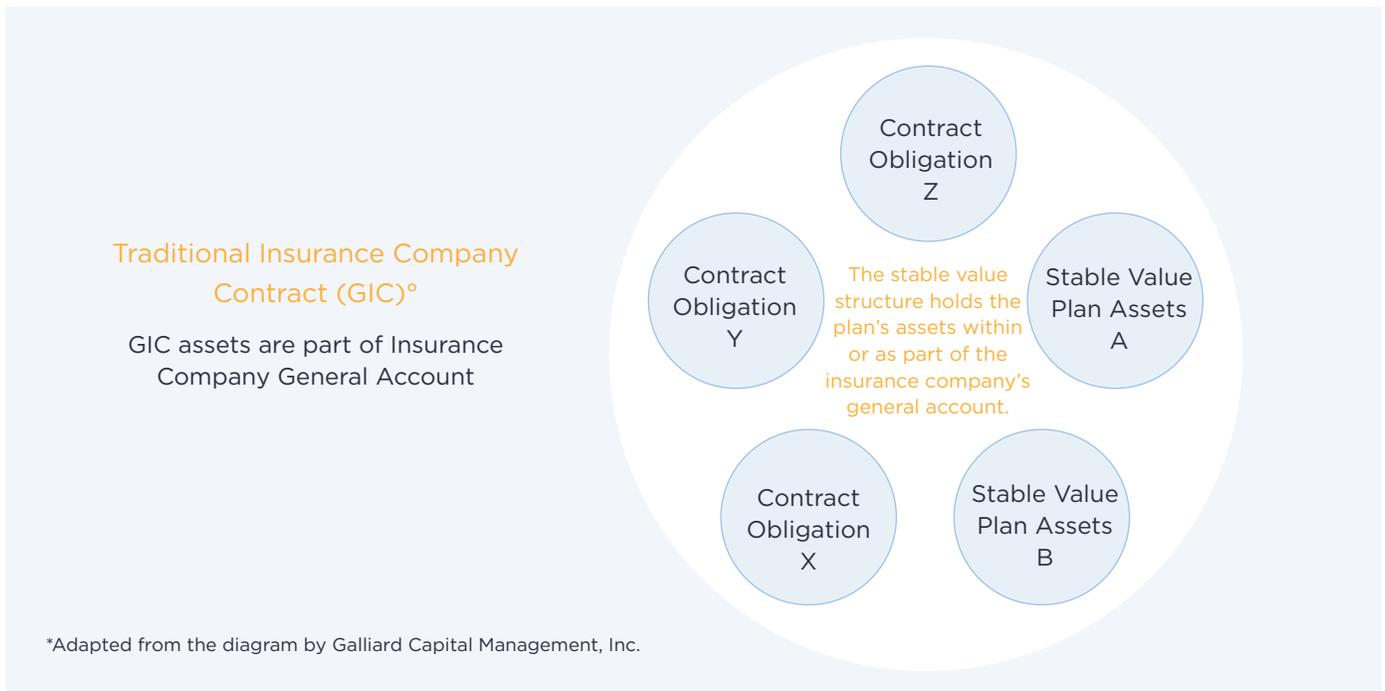
As mentioned in the introduction, stable value products can be structured in two main ways in order to protect the book value of the participants’ investments: Insurance company general account or a commingled investment trust (CIT) “pooled” product. There is a third option, an insurance company separate account available for larger plans (Note: A plan typically needs to have about \$50mm in stable value assets to justify the cost of a separate account) but as mentioned earlier in the introduction, we only discuss insurance company general account and CIT pooled products as the two main types of stable value products.) Later in this paper, we will directly compare these two different approaches to stable value construction and provide a framework to evaluating their strengths relative to one another. The first step is to understand how these products are built in order to better understand how they stack up against each other.

### Stable Value Product Type #1 - Insurance Company General Account Products

An insurance company can structure a stable value fund as a traditional Guaranteed Investment Contract (GIC), a group annuity contract issued by the insurance company providing a guarantee of principal and accumulated interest. Plan assets are owned by the insurance company and are part of the insurer’s General Account. Stable value contract holders, the plan sponsor and plan participants are creditors of the insurer and do not have priority claim status on the General Account assets of the insurance company. At a simple level, the crediting rate is determined by the gross crediting rate of the general account less the “spread” that the insurance company keeps to compensate itself for the cost of maintaining the product as well as generating a profit margin. Contract holders of an insurance company stable value product are subject to the financial strength of a single insurance company. This means that in the event the insurer goes bankrupt, there is no guarantee how much money, if any, the participant will receive. Usually with this type of product there is little transparency regarding the underlying investment portfolio and the product’s actual fees making it difficult to know exactly what the portfolio is invested in and how much the insurance company charges in fees. In this regard, GA products are like bank CD products – they are both commonly referred to as “spread” products because the fee the issuer receives is the difference between the gross and net crediting rates. This lack of transparency is partially offset by a generally higher crediting rate and depending on the specific product, perhaps even a guaranteed minimum crediting rate (e.g., a 1% floor) compared to a “synthetic” or “pooled” product described next.

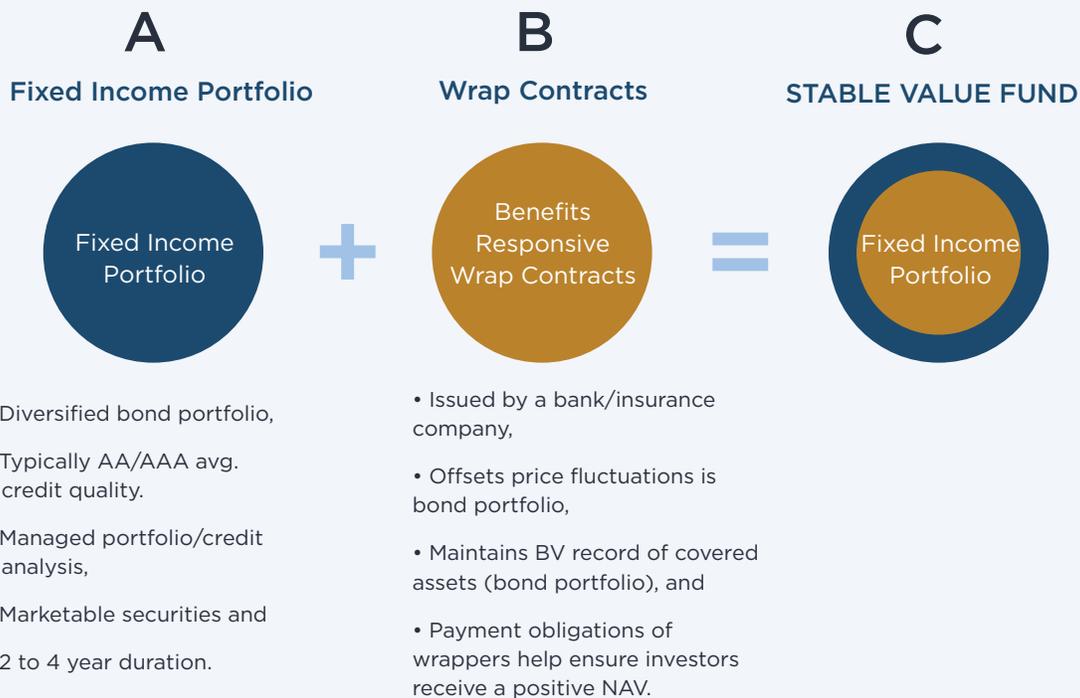
## Stable Value Product Type #2 Commingled or Pooled Products

A commingled or “pooled” stable value fund product is a fund operated by a trust company or a bank for the exclusive use of qualified retirement plans. Pooled products combine the assets of unrelated ERISA retirement plans, enabling plan sponsors to gain economies of scale within a single stable value strategy. Just like the insurance company GA products, they provide participants daily access to their funds without redemption fees; however, there are usually restrictions on transferring from the stable value option to a “competing” fund like a money market fund or a short-term bond fund.



In a pooled product, the largest allocation is to “Synthetic” or Security-Backed Guaranteed Investment Contracts issued by multiple banks or insurance companies. These contracts comprise two components: 1) The underlying portfolio of high quality bonds and 2) One or more book value wrap contract(s) issued by a financial institution(s). The wrap contract ensures that participants can transact at book value, without experiencing the price fluctuations of the underlying bond portfolio. And unlike a traditional GIC (discussed above), the plan has an equitable interest in the stable value bond portfolio. In a traditional GIC structure, the insurance company’s general account portfolio and the product’s fees are not readily transparent and the participant is subject to single insurer risk. In a pooled product, the participant does not receive an explicit guarantee of return, but the plan is not subject to single insurer risk, the product fees are disclosed and the underlying fixed income investment portfolio that drives the overall return of the stable value fund is transparent.

### Key Components of a Stable Value Fund



## MORE ABOUT STABLE VALUE FEES:

### Where's My Expense Ratio?

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Stable value fees can be confusing. For certain types of products like the pooled funds described above, fees are expressed as an expense ratio making it easy to compare products. For other types of products like traditional insurance company general account products, the underlying costs are not reported as an expense ratio. In fact, insurance companies are not required to disclose their stable value product fees and can legally represent their fees as zero to investors. As we discussed before, what's really happening is that the insurance company makes its money from "spread" i.e., where the investments generate more in profit than the cost of deposits. In this case, the underlying fees are usually netted out of the gross crediting rate making it difficult for plan sponsors or participants to determine the product's exact costs. This spread is a significant source of income for general account product manufacturers.

If you don't see an explicit cost then you can assume that the fees - whatever they happen to be - are being netted out of the gross return. As a plan advisor, you want to document asking for a detailed breakout of fees in order to help your client to make an informed buying decision. The fees for investing in stable value products typically range from 25 basis points (0.25%) on very large plans to 100 basis points (1%) for small plans. Similar to mutual funds, many pooled funds offer multiple share classes designed to provide different levels of revenue sharing to the recordkeeper, and pay higher expenses to the product provider depending upon the size of the plan's investment. Regardless of the fees, understanding how much revenue the stable value fund generates to offset recordkeeping fees is a key responsibility for fiduciary advisors. It is also worth noting that there can be different offset rates for the same product depending on which recordkeeping platform you are using at the time.

In some instances, a plan's recordkeeper is an insurance company, which also offers its own stable value product, most often a traditional GIC structure from the insurer's General Account. The fees for that product often consist of both a recordkeeping fee and an investment management fee. However, as mentioned earlier, these fees are almost always implicit, and are typically not disclosed to the participant. Given the focus on fees, it is incumbent on the fiduciary advisor to determine the recordkeeping offset as these can vary between the stable value fund and various recordkeepers.

## **DIRECT COMPARISON OF STABLE VALUE PRODUCTS:** **Ins. Company General Account vs. Commingled Pooled Product**

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As to the question, “Is one type of stable value product design fundamentally better than the other?”, the short answer is an emphatic no – it really depends on your client’s situation and objectives. The first step is to understand how these products are built so you can then begin to appreciate each design’s relative strengths and weaknesses. Some advisors will not use any general account products because they argue that the financial risk inherent in one insurance company coupled with the lower levels of transparency around the underlying investment portfolio and fees disqualify them from consideration in a client’s portfolio. Other advisors are more focused on higher crediting rates or a minimum crediting rate floor or an explicit guarantee of principal protection and are willing to subordinate single insurer risk and a lower level of transparency to achieve these other priorities. In short, one stable value investment product type may be more appropriate than another depending on the client’s situation.

The main take away is that if you follow a due diligent process, you can recommend either type of product. For insurance company products, this means highlighting to the client the risk inherent with a single insurer but it shouldn’t automatically disqualify it from consideration especially if other features like key contract provisions, the crediting rate and the financial strength of the insurance company are overwhelmingly positive. Conversely, if you recommend a pooled product you need to understand the fees, the underlying investment portfolio and the nature and quality of the underlying wrap protection and how these contracts work together. And in either case, you want to understand how the discontinuance provision works for either type of product in case your client ever decides to exit the product.

The table below provides an overview of the two most common stable value structures offered to plan sponsors. The key in stable value selection and monitoring is process and this means understanding key product features and point-in-time data points.

|   | Insurance Company<br>General Account GIC SV Funds  | Pooled Stable<br>Value Funds With Multiple Wrappers   |
|---|--|---|
| Who holds legal title to the assets?  | Insurer's General Account.   | Pooled fund manager, which diversifies against single insurer risk by using wrap providers.   |
| What type of principal protection is offered?                                       | The principal is guaranteed. State insurance laws protect against insurance company defaults or bankruptcy. There are state-by-state limits, some on omnibus basis some on allocated basis** | Wrap contracts protect against market value risk; typically does not guarantee the return of principal for defaulted securities.  |
| What type of crediting rate guarantee is typically offered?                         | Minimum crediting rate greater than 0% (usually b/t 1% - 3%) is guaranteed. The crediting rate is reset periodically e.g., quarterly, semi-annually or annually.                             | Typically, there is no minimum crediting rate. The rate can fluctuate based on market conditions and the underlying performance of the portfolio.   |
| Who manages the assets and type of assets?  | Insurer. Assets consist primarily of high quality fixed income but they may also include less liquid assets such as alternatives, real estate and private placements.                        | One or multiple fixed income managers. Assets consist primarily of high quality fixed income.   |
| Who provides the guarantee?   | The insurer provides an explicit contractual guarantee backed by the overall credit quality (i.e., "claims paying ability") of the ins. company.   | One or multiple wrap providers selected from insurers, banks, or other financial products companies protect against loss of principal due to interest rate volatility but there is no explicit guarantee. |
| What is the risk of losing protections offered by the guarantee?                    | If structured properly, the guarantee is backed by full faith and credit of the single insurer.  | Portfolio protection is backed by the credit of one or multiple guarantee providers.  |
| What is the risk of losing access to the assets?                                    | If the insurer becomes insolvent, investors will become a creditor of the insurer's assets.  | Assets are held by the pooled fund and are owned by the plan sponsor.   |
| What protections are available if a guarantee provider cannot meet its obligations? | If structured properly, state insurance insolvency laws give preferential treatment to policy holder claims.   | If any guarantee provider cannot meet its obligations, other providers must step in to fulfill that provider's obligations.   |
| Purchase Decision Criteria  | Sponsors seeking a "turn-key" solution can opt for this general account product, which requires only the selection of a single provider to manage the assets and provide the guarantee.      | Plans seeking the assurance of wrap providers backing the guarantee can select a global wrap product.   |

# KEY QUESTIONS FOR EVALUATING A STABLE VALUE FUND

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Irrespective of what type of product you recommend to your client, we have listed below a series of questions fiduciary advisors should ask when evaluating a stable value fund and when comparing different stable value products across a number of important product design dimensions.

## What is the fund's current market-to-book value ratio?

A ratio greater than 1 is preferable. A ratio lower than 1 indicates that the value of the investments has fallen below the dollar amount contributed by participants, or the book value. Participants who are withdrawing cash from the fund are now relying on the insurer or wrap providers to cover the difference between market value and the book value of the total contributions. That said, market-to-book ratios move over time based on cash flows, interest rates and underlying portfolio performance and being below 1 for a period of time is not in and of itself a sign of trouble.

## What is the current crediting rate paid to participants, and how does it compare to the rate paid by other stable value funds and the yield earned on money market funds? What has the crediting rate looked like over the past 1, 3 and 5 years?

## What are the product's fees? How are they determined?

In the case of a pooled fund, it will be expressed as an "expense ratio" but in the case of a guaranteed product, there may be no specific mention of fees. In this case, you will need to ask the provider for a detailed breakout of fees that are deducted from the fund's gross crediting rate.

## Which financial institutions are wrapping the fund, or the bonds owned by the fund? What are the most recent credit ratings and outlooks on these companies from the credit rating agencies?

Knowing the financial condition of the wrap providers is an essential step in evaluating the overall risk of the fund. This is critically important when evaluating stable value products offered by the insurance companies, which are "self-insured."

# KEY QUESTIONS FOR EVALUATING A STABLE VALUE FUND

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If the plan sponsor decides to terminate a stable value fund, how will the stable assets be paid out?

Typically, a fund pays out at the lesser of book or market.

Also, how much time must pass before all the participants can receive their funds at full value?

This is known as the “put” provision and is critically important for the advisor and the plan sponsor client to understand. For some funds, the withdrawal provisions are inflexible – i.e., there is always a market value adjustment, or there is always a 12-month put. Other funds give the plan the choice between the two options. Making sure your client knows what kind of put provision he signed onto is a key advisor responsibility.

Also, how much time must pass before all the participants can receive their funds at full value?

Plan sponsors should select fund managers with a large, dedicated team with stable value product and fixed income expertise.

How long have they been running the fund? What is their risk-adjusted track record compared to appropriate benchmarks and peer group?

Having multiple sub advisors can provide participants with diversification of manager risk. In the event the stable value fund changes a sub advisor, it is imperative that thorough manager due diligence is performed. If the stable value fund changes sub advisors frequently, this is a sign that proper manager due diligence may not have been conducted.

## THINGS GOOD ADVISORS ARE AWARE OF

As we discussed before, the days of selecting a stable value product based solely on crediting rate are over. Good fiduciary advisors analyze, compare and select a stable value fund based on a prudent due diligence process. We break the due diligence process down into six evaluation criteria. (Note: The boxes coded in gold represent the risk factors to which GAs may have a heightened risk profile):

| Transparency      | Flexibility          | Structure         | Management                  | Value              | Performance        |
|-------------------|----------------------|-------------------|-----------------------------|--------------------|--------------------|
| What am I buying? | What are my options? | How does it work? | Are the managers qualified? | What does it cost? | What is my return? |

When investing in a GIC, a plan may be more restricted than the sponsor realizes, specifically with regards to the “Put Provision”. A Put Provision details what happens when a plan sponsor redeems the investment and most funds offer two options. The first is an immediate payout based on a lesser of book or market value. Depending on the market-to-book ratio and interest rates, the stable value fund could take a “haircut” meaning it pays out less to participants than current book value.

The second discontinuance option is usually a 1-year or 5-year “put” option. This option means that the plan will receive its assets over a 1- or 5-year period, which is a long time to worry about participants transacting out of the fund. Additionally, during this 5-year period, some contracts become “non-benefit responsive”, meaning that they will not allow participants to redeem during this period.

Additionally, when buying a GIC, there may be an issue of “portability”. Portability relates to how easy it is to switch from one custodian/recordkeeper to another if a plan sponsor wants to make a change. GICs are particularly non-portable because they are often offered as part of a “bundled” solution, meaning the issuer of the GIC also serves as the plan recordkeeper. This allows the recordkeepers with GIC products to maintain plan assets because they can often subsidize the recordkeeping cost if the plan uses its proprietary GIC. The upshot is that a plan sponsor could potentially invest in a GIC for a period far longer than they bargained for.

Also, the structure of a GIC can put a plan’s assets at risk since being a part of an insurance company’s general account makes the plan a general creditor of the insurer. This means that if the insurer were to become insolvent, a plan would essentially file a claim just like any other creditor. Of course, there is a low probability of default among highly rated insurers, and in case of emergency there are “state guaranty funds” that act as a backstop to insurers, but it is a risk and one that a prudent fiduciary needs to weigh, especially for an investment option that is supposed to be “safe” for participants. It also highlights the need to analyze the financial strength of the insurer.

Finally, it is important that a fiduciary know the cost structure of any investment in their portfolio. With a GIC, the true cost of the investment is difficult to know for certain. This is because a GIC is a “spread” product. A spread, in this instance, is the difference between the rate of return the insurance company earns on its general account investment activity, and the interest that it pays to the plan. This difference is the amount the insurance company keeps from investing the plan’s assets, and could be considered the true cost of the investment. Oftentimes, the spread earned can be several hundred basis points, which, if expressed as an expense ratio, would be egregiously high. Some would argue that the spread doesn’t matter as long as participants are getting a fair crediting rate, i.e., the net return. However, it is important to remember that this spread is being earned by investing the plan’s assets, the same way that any asset manager earns their fee. In theory, a larger portion of this spread could be going to the participants of the plan rather than in the pockets of the insurer.

## WHERE TO GET MORE INFORMATION

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As you begin the due diligence process, you want to ask each potential stable value provider for detailed information about each fund. This can be a time consuming process but there is now a market-ready solution to compare and analyze multiple stable value products quickly and easily.

Fi360, the nation's leading provider of fiduciary-related education and technology, has a powerful online stable value due diligence tool built for advisors they call, Fi360 Stable Value Vision. The online tool is designed for advisors who are looking for a powerful yet easy-to-use tool that will allow them to compare and contrast various stable value products across multiple data points on all the major 401(k) recordkeeper's platforms.

The tool allows the advisor to weight 10+ key selection criteria and then compares the products that meet the selection criteria across key product features and dimensions including structure type, wrap providers, portfolio stats, historical return information, fees, contract features, etc. It also contains write ups of the recommended stable value products. The backbone of the tool is the industry's largest stable value database which currently covers nearly 60 products representing close to \$500 billion in SV assets, or about two-thirds of the "off the shelf" SV marketplace.

For more information on the tool, visit:  
[www.fi360.com/StableValue](http://www.fi360.com/StableValue)

## **BEST PRACTICES FOR ADVISORS**

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As a good advisor, it's important to periodically revisit the decision to include stable value in your client's portfolio. As part of that process, some important topics to review with your client include the following:

- Stable value returns vs. Money Market - Why stable value was selected in the first place?
- Review of the product type: Ins. Company GA vs. CIT "pooled" product - A brief overview of the two main types of stable value architecture and why one product was selected over the other.
- A review of the current product vs. other stable value products that are available on the recordkeeper's platform - Assuming the recordkeeper offers different products to choose from, it makes sense to periodically review the other available products in terms of key metrics like ratings of the insurance company and/or underlying wrap contracts, market-to-book ratio, crediting rate, competing funds, key contract provisions, etc.
- Fee Review and Recordkeeping Offsets - To the extent you can get fee information, review this information with your client including how much of the revenue is generated by stable value to offset recordkeeping fees.
- Review of the "Put" provision and how it works - This is critical as most plan sponsors don't understand this.

Committee members come and go and change over time. Given the importance of stable value in the 401(k) marketplace, it is incumbent upon the advisor to review these key topics with their committee clients or risk possibly losing the business to more savvy fiduciary advisors.

## DEALING WITH PUT PROVISIONS

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The last bullet above takes on particular importance if the plan sponsor engages you to conduct a due diligent recordkeeper search. In that case, you need to formally notify the stable value provider that you intend to terminate the stable value contract which then puts the client in a discontinuance queue. Depending on the contract, participants may have to wait a year (and possibly longer) before they receive their money.

Depending on your client's total plan size, there are different ways to deal with this issue. For mid market plans, the new recordkeeper can usually create a blended rate that mixes the "old" stable value crediting rate with the "new" fund's crediting rate. While the put provision expires, participants who retire or terminate service are usually able to access their stable value assets if they wish to roll them out of the plan.

For small plans and plans that use a group annuity product, creating a blended rate is probably not an option in which case the "market value adjustment" (MVA) may apply. Good advisors understand these details, remind their clients of them and help their clients create a strategy for change including drafting and managing participant communications to minimize loss and to address their concerns.

## SYNOPSIS

- Stable value is an important asset class and will continue to remain relevant as more plans are re-designed to encourage retirees to keep their assets in the plan.
- Stable value has historically outperformed money market funds by a significant margin because the underlying investments have a much longer duration.
- There are two main types of stable value “architecture” – insurance company “general account” and commingled or “pooled” products.
- It is no longer acceptable for advisors to exclude stable value from the investment due diligence they regularly perform on equity and fixed income funds. Nor is it acceptable to rely on just one data point such as the crediting rate, for example, as the basis of a stable value recommendation to a client.
- There are new, easy-to-use sources of detailed stable value information available to advisors that allow them to easily conduct detailed due diligence on different stable value products.  
[www.fi360.com/StableValue](http://www.fi360.com/StableValue)
- It is important to periodically conduct ongoing due diligence on the stable value offering in your client’s portfolio to remind them of key contract provisions like the put provision, credit quality of the insurer or of the underlying wrap providers and how the returns stack up against other products that may be available on the platform.

## SV GLOSSARY/DEFINITIONS

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**All-in (Gross) Expense Ratio** – The total cost of the overall product, also known as the gross expense ratio, that includes all investment management fees, insurance company wrap fees, administrative fees, revenue sharing, and any other applicable fees that an investor would pay for the product.

**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 caused by movements in interest rate or changes in credit ratings.

**Cash Flow Risk** – The risk that participant-directed contributions, withdrawals and net transfers have a financial impact on the issuer of a fixed rate contract or on the crediting rate of an experience-rated contract. Also, the risk that cash flows are different than expected.

**Commingled Fund** – A fund that combines assets from different and unaffiliated plans into one large group to achieve economies of scale. These funds may also be referred to as pooled funds, bank pooled funds, or separate accounts.

**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.

**Crediting Rate Floor** – The lowest acceptable credit rating that the product may offer its investors. Even though a credit rate has a zero credit floor, this does not mean the investor is guaranteed not to lose money.

**Credit (or Default) Risk** – The risk that an investment will default, i.e., the borrower (the bond or contract issuer) will not pay the interest and principal as scheduled.

**Duration** – A metric that measures the sensitivity of the price of a fixed income security to a change in interest rates. Duration is expressed in years. Interest rates and fixed income products have an inverse relationship, i.e. rising rates mean falling prices. Higher duration indicates more sensitivity to interest rates and a larger movement in prices.

**Equity Wash** – A provision in a stable value product that stipulates 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.

**Fair Market Value (FMV)** – The amount that a willing buyer will pay a willing seller for a future income stream. Fair value is usually reported as market value.

**General Account** – The primary part of a life insurance company's balance sheet containing the capital and surplus and reserves for guaranteed liabilities. Almost all traditional GICs are backed by the issuer's General Account.

**Guaranteed Rate** – The rate of return under a guaranteed investment contract for a stated period of time.

**Guaranteed Investment Contract (GIC)** – A group annuity contract that pays a specified rate of return for a specific period of time, offers book value accounting, typically pays benefits to plan participants, and provides annuities upon request. These contracts are also known as Guaranteed Interest Contracts or Guaranteed Insurance Contracts.

**Gross Crediting Rate** – The interest rate on the book value balance of a stable value product before adjusting for expenses and any special provision of the product.

**Investment Guidelines** – Guidelines established between a plan sponsor or trustee and an investment manager which establish the investment parameters and risk exposures that the investment manager may assume in the plan's account. In fixed income portfolios, the guidelines typically address permissible asset classes and/or securities, sector allocation limits, issuer diversification, and minimum credit quality constraints.

**Investment Manager** – A fiduciary (other than a trustee or named fiduciary under Sec. 402 of the IRC) who has the power to manage, acquire or dispose of certain plan assets and who has acknowledged in writing that he is a fiduciary with respect to the plan.

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

**Market Value Accounting** – Adjusts the plan with the volatility of market fluctuations caused by movements in interest rates or changes in credit ratings. Stable Value products generally do not use Market Value Accounting, and focus on Book Value Accounting.

**Market to Book Ratio** – This ratio takes the book value (value of deposits, plus accumulated interest, minus withdrawals) divided by the market value, the amount an investment would be worth if it were sold at a specific time. A ratio higher than 100 is preferable. A ratio lower than 100 indicates that the value of the investments has fallen below the dollar amount contributed by participants, or the book value. Participants who are withdrawing cash from the fund are now relying on the insurer to cover the difference between market value and the book value of the total contributions.

**Market Value Adjustments** – More properly referred to as Surrender Value Adjustments, this is the amount deducted from or added to a stable value product when it is terminated prior to its stated maturity date.

**Net Crediting Rate** – The interest rate on the book value balance of a stable value product after adjusting for expenses and any special provisions of the product, expressed as an annual effective yield.

**Net Expense Ratio** - The expense ratio of the fund that includes all investment management fees, insurance company wrap fees, administrative fees, and any other applicable fees that an investor would pay for the product with the exception of any revenue sharing that is offered.

**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.

**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 managers 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.

**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).