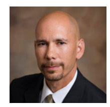
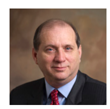
Cash Flows and Put Queues

Impacts may be positive or negative depending on market conditions.

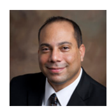
October 2019



Antonio L. Luna, CFA
Head of Stable Value, Portfolio Manager



Robert A. Madore
Portfolio Manager, Stable Value



Whitney H. Reid, CFA
Portfolio Specialist, Stable Value

Plan sponsors often ask questions about cash flows and how they may impact stable value funds. In general, positive cash flows are good for a stable value fund, not only from a crediting rate perspective, but also in terms of the market-to-book-value ratio. Negative cash flows, however, can be both positive and negative for stable value funds. As highlighted in Figure 1, the net effect of cash flows really depends on the direction of interest rates, the size of the cash flows, and the current state of a fund's market-to-book-value ratio.

In general, cash flows come from three areas—daily participant activity, new plan-level accounts, and plan withdrawals reflected in the fund's put queue (i.e., its list of pending plan withdrawals). Participant cash flows can be large when aggregated, and perhaps large enough to impact a stable value fund's crediting rate, especially if they occur when external events cause a "flight to quality." Participant behavior in stable-value investments tends to move in the opposite direction from equity markets, with a time lag. When equity markets are performing well, money tends to move out of stable value and into equity investment options. If equity markets are volatile or in decline, participants tend to move money out of equities and into a principal preservation strategy like stable value. So in general, participants tend to move money into stable value when equity markets sell off and out of stable value and into equity markets when equities rally. In addition, as mentioned previously, external events that result in a flight to quality can cause larger cash flow moves into stable value funds.

Plans that are changing stable value managers typically will fund their new stable value account, in cash, after a put period, which is typically 12 months. Assets may come from non-stable value investments, like money market funds, which are also funded in cash, but without a 12-month put or waiting period.

Some stable value managers will allow plans to withdraw the funds in their accounts early if the manager has ample liquidity and market-to-book-value ratios are above par, but most typically will enforce the put provision waiting period. This is largely due to the careful planning that goes in to product changes and the participant communications that go along with them. Although the assets may become available for withdrawal early, it could be difficult for plans to make last minute changes to their withdrawal schedule and move their plan's assets on a date other than one previously decided upon, which is typically the put expiration date.

Account turnover in stable value funds usually is related to recordkeeper changes, but it also may be performance-related. In general, a stable value fund's put queue is loosely aligned, in percentage terms, with the size of the fund's cash buffer, which typically ranges between 5% and 10% of fund assets.

In a scenario where a fund's put queue exceeds the typical buffer range of 5% to 10%, the stable value portfolio manager may be forced to alter its asset allocation and hold higher cash buffer balances in anticipation of additional plan withdrawals over the next 12 months. In this scenario, the fund's performance may be negatively impacted not only by the cash outflows but also by the higher levels allocated to the cash buffer, which is usually the lowest yielding portion of a stable value fund's portfolio.

In summary, cash flows are the lifeblood of any stable value fund. Positive cash flows are good, while negative cash flows may be both good and bad as it relates to the fund's yield and market-to-book-value ratio. These impacts ultimately depend on current and future interest rates, both the fund's cash inflows and the size of potential fund cash outflows, and the fund's market-to-book-value ratio.

(Fig. 1) Stable Value Fund Cash Flows and Their Impact on Crediting Rates

Market Environment		Crediting Rate Impact
Rising Rate Environment		
Cash Flow	Inflows	Positive
	Outflows	Negative
Declining Rate Environment		
Cash Flow	Inflows	Negative
	Outflows	Positive

Source: T. Rowe Price.

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