New Wrap Capacity Offers More Opportunity for Growth … and Competition

By Randy Myers

The stable value industry has a new focus on growth.

In the aftermath of the 2008 credit crisis, a number of stable value wrap issuers exited the business, constraining the industry's ability to grow. But over the past few years new issuers have entered the market, and veteran players have increased their appetite for new business. The result is that the industry has $87.75 billion in new wrap capacity available for 2014, according to a survey conducted by the Stable Value Investment Association. And that could eventually have an impact not only on the industry's growth but also wrap issuers' fees and contract terms.

Speaking at the SVIA's 2014 Spring Seminar, Marijn Smit, president of Transamerica Stable Value Solutions, said 25 issuers were surveyed in March 2014, with 23 responding. They included 22 current issuers and one potential entrant to the market. The 22 current issuers reported $544 billion in product balances at year-end 2013, up from $443 billion among 20 survey respondents the prior year, and $424 billion from 18 respondents two years earlier.

Of the business already on the books at the end of last year, 55 percent represented synthetic GICs, 23 percent separate account GICs, 20 percent general account GICs and 2 percent traditional GICs. New capacity is similarly aligned: 58.1 percent is available for synthetic GICs and another 13.4 percent for commingled synthetic GICs, 18.2 percent for separate account GICs, 8.3 percent for general account GICs, 1.7 percent for traditional GICs and 0.3 percent for commingled GICs.

As part of the survey, issuers were asked what might inhibit their appetite for business in 2014. For both pooled fund and separate account/single fund business, the biggest concern, cited by about three-quarters of the respondents, was the presence of competing funds in a retirement plan that had no equity wash provision to minimize interest-rate arbitrage. In the case of pooled funds, the other top issues were duration limits greater than three years on underlying investments (cited by 52 percent of respondents) and market value/book value ratios for a stable value fund below par (48 percent). For separate accounts and single funds, below-par market-to-book ratios also were a top concern (39 percent of survey respondents), but duration limits were less worrisome, cited by only 13 percent of respondents.

Competitive pressures?

The availability of new capacity doesn't mean that it will all be used, observed Smit, who participated in a panel discussion of the survey findings with other wrap issuers. In 2013, he noted, issuers had indicated $103.5 billion in new capacity available and only used $48.76 billion of it. In 2012 they offered $77.5 billion in new capacity and used $26.98 billion.

"This could mean that we have capacity chasing a more limited opportunity set, which could translate into competitive pressures," Smit said. But he quickly discouraged any notion that issuers should become too lax in their investment guidelines or pricing standards. "At Transamerica, we believe the risk-return profile from an issuer perspective is appropriate the way it stands, and we don't think the industry would be well-served by a renewed race to the bottom," he said.

Jessica Mohan, managing director with Bank of Tokyo-Mitsubishi UFI Ltd., offered similar sentiments. "One of the things we learned from 2008 was that the viability of this product is inextricably tied to wrap capacity," Mohan said. "The market can't grow unless there is capacity available. Now, we see there's plenty. I think that's a result of the hard work done by investment managers partnering with their service providers for more conservative investment guidelines and more consistency across contract terms."

Tom Schuster, vice president of stable value management for Metropolitan Life Insurance Co., conceded that stable value investment guidelines had become too broad and wrap fees too low prior to the credit crisis. He said the industry is now in a much better position. But he also said that while wrap issuers need appropriate pay and protection for the risks they are taking, investment managers need investment guidelines that allow them to enhance the performance of their funds. "Ultimately," he said, "we need to deliver a product that is attractive to plan participants."

MetLife wraps more than 20 subadvisors in a little more than 50 manager mandate combinations, Schuster said. Immediately after the credit crisis, he said, the company probably didn't differentiate as much as it should have, based on manager capabilities and competencies, when negotiating investment guidelines. But he added that over the last 18 to 24 months MetLife has been willing to wrap investment guidelines that are more tailored to the manager's capabilities, which he thinks enhances his firm's risk profile. "The goal is to allow the manager to perform based on capabilities where they demonstrate strength," he said. "And if they are able to demonstrate that capability then they should be given more flexibility."

"I would echo that," added Frederick Ramos, senior managing director with State Street Bank & Trust Co., saying that if an investment manager sees an opportunity that falls a little outside its investment guidelines but is in line with its expertise and capabilities, State Street is happy to discuss it.

For all the progress that's been made in tightening investment guidelines, and in standardizing contract terms for stable value funds with multiple wrap providers, the consensus of the panel seemed to be that establishing the right guidelines and contract terms will remain an ongoing exercise.

"While (the industry is) trying to be generous with the guidelines and find that middle ground where they are wide enough for managers to add value but tight enough so that the cost of doing business is not prohibitive, there is a dynamic that is still playing out," said Marc Magnoli, executive director of AIG.

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