Evaluating Fiduciary Risks

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funds. "Of course, if you're picking an index that is based on an average of a lot of different investment options, by definition about half will underperform," Blumenfeld noted. He said the case includes other absurdities. For example, of the four named plaintiffs, three had not invested in the Lockheed Martin stable value fund at all, and the one who had did so during a period in which it outperformed the Hueler Index.

In yet another case, involving Cigna Corp., participants in the company's 401(k) plan challenged not only the performance of the plan's stable value fund, but also argued that it should have had a more diverse collection of wrap contracts. The plaintiffs also complained about the fund's crediting rate not matching the performance of the fund's underlying investments. Cigna denied liability but settled the suit for $35 million. As part of the settlement, it agreed to hire an independent consultant to monitor and advise on the stable value fund and other investments in its 401(k) plan.

The lesson for service providers, Blumenfeld said, is to make sure their clients understand the products and services they're buying, and, to the extent possible, put that information in writing and keep reminding clients of it. "It doesn't do them any good if they forget or don't understand, and it doesn't do you any good," he said.

Blumenfeld also recommended that service providers and plan sponsors alike establish and document prudent processes for choosing and managing stable value products. Areas to be mindful of include performance, fees, wrap costs, wrap diversification, and crediting rates.

On the regulatory front, Michael Richman, of counsel to Morgan, Lewis & Bockius, updated Forum participants on what's been happening in the year since plan sponsors and service providers became subject to new disclosure requirements under ERISA sections 408(b)2 and 404(a)5. The former requires service providers to disclose information about their fees and fiduciary status to their plan sponsor clients, while the latter requires sponsors to disclose information about plan expenses to plan participants.

Richman noted that 408(b)2 allows service providers to make disclosures once and forego annual updates unless something changes. However, he said, a number of providers are doing annual updates anyway to make sure they didn't miss any changes and to ensure that all their clients have up-to-date information. Meanwhile, the Department of Labor is considering mandating a new "Form of Disclosure" guide under 408(b)2 that could serve as a roadmap for finding disclosures in the documents provided to plan sponsors. However, he said, the initiative is apparently on hold under pressure from industry trade associations.

In other regulatory developments, Richman said the DOL is still considering whether to broaden the circumstances under which a service provider could be deemed a fiduciary under ERISA. The DOL has said it will re-propose such a rule, but it has not done so yet and action, Richman said, does not appear imminent.

Elsewhere, both the DOL and the Securities and Exchange Commission are considering new rules for target-date fund disclosures. The DOL had expected to issue a final rule in November of this year, Richman said, but it now appears that will not happen.

Finally, Richman noted, the DOL has issued an advance notice of proposed rulemaking that would impact defined contribution plans. Plans would be required to include in the benefit statements sent out to plan participants an estimate of what a participant's account balance might be worth in terms of lifetime income. The DOL is currently reviewing comments on its proposal.

In terms of Department of Labor investigations, Richman said it's hard to discern trends because little information about them is made public. He did note, though, that the DOL has made a number of general requests to service providers asking for broad amounts of information. "When you drill down, it turns out that, in some of the ones we've seen, the focus is on certain issues: abandoned plans, which is an issue for the Department of Labor if a company is gone and there is no fiduciary to wind down the plan," he said. "There's a DOL initiative, and some regulations out there, that allow the Department of Labor to step in, or for a process where a service provider appoints someone to take over the plan and wind it down."

The DOL also appears to be looking into trade errors made when a plan moves its assets to another provider, Richman said. SVIA

Stable Value Roundtable

By Randy Myers

What's happening in the stable value market? Seven experts from diverse sectors of the industry brought participants at the 2013 SVIA Fall Forum up to speed during a lively roundtable discussion in Washington, D.C. Among the highlights:

Wrap diversification: A preference for having multiple wrap contract providers for a stable value fund still persists among retirement plan sponsors, said Warren Howe, national sales director for stable value markets at Metropolitan Life Insurance Co. But he said the fact that some plan sponsors embraced single-wrap insurance-company stable value products in the aftermath of the 2008 credit crisis, when wrap capacity was constrained, demonstrated that many have become more comfortable with that approach, too.

Unwrapped stable value portfolios: A few defined contribution plans introduced market-value sleeves of securities into their stable value funds prior to the 2008 financial crisis, and interest in such structures increased after the crisis when stable value wrap capacity became constrained, said Jessica Mohan, managing director with Bank of Tokyo-Mitsubishi UFI Ltd., where she oversees its stable value business. Mohan says her firm hasn't done any new transactions with funds that have included market-value sleeves, but "we're ready to." She suggested that these unwrapped portfolios should generally adhere to the investment guidelines established for the wrapped portion of a stable value fund, and that plan sponsors who offer such funds should communicate to their plan participants that their fund is "not 100 percent a stable value fund."

Tom Schuster, vice president of stable value management with Metropolitan Life, warned that there is headline risk associated with such structures if they lose money and plan participants later say they thought they had been getting traditional stable value guarantees. "It's not a stable value fund," he said, adding that he doesn't think the structures make much sense

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for any plan that can secure sufficient wrap coverage to offer a "100 percent" stable value option.

Shorter-duration portfolios: Douglas Barry, executive vice president with Standish Mellon Asset Management Co., said that like many stable value managers, his firm has been managing to some shorter-duration benchmarks for many clients, typically in the range of 3.5 to 4 years. "We're incorporating more 1-to-5 year (maturity) strategies, with a duration of about 2.5 years," he said, "and we're okay with that given where we are in the interest-rate cycle."

Wrap capacity and pooled fund closings: A contraction in stable value wrap capacity following the 2008 financial crisis forced some pooled stable value funds to close or limit new deposits. Steve LeLaurin, senior client portfolio manager for Invesco Advisors Inc., said wrap capacity has since improved. Metropolitan Life's Schuster said that while some smaller, top-heavy pooled funds may continue to find it difficult to secure sufficient wrap capacity to do new business, he thinks well-diversified, transparent funds, especially those with longer put structures, will continue to get all the capacity they need. (A top-heavy pooled fund is one in which a handful of plans account for the bulk of the fund's assets. A "put" refers to the length of time—usually 12 months—that a defined contribution plan must give a pooled fund to carry out the plan's exit from the fund.) LeLaurin said that his own firm "had a limited soft close for a while until we could get additional wrap capacity, allowing us to reopen on a cautious basis."

The impact of rising rates on wrap capacity: If interest rates began to rise sharply, market-value-to-book-value ratios for stable value funds would likely fall, at least temporarily. Schuster said Metropolitan Life's appetite to write new business might become constrained if those ratios fell too much. "At a ratio of around 98 percent, assuming cash flow remains strong, we'd still be in the market," he said. "When you start hitting 95 percent, that's where you hit a bit of a pause, at least from MetLife's perspective. At 95 percent I believe you see wrap capacity start to become a little constrained." Mohan

From the left: Angelo Auriemma, Plan Sponsor Advisors; Douglas Barry, Standish Mellon Asset Management; Matt Gleason, Dwight Asset Management; Stephen LeLaurin, Invesco; Jessica Mohan, Bank of Tokyo-Mitsubishi UFJ Ltd.; Warren Howe, Metropolitan Life Insurance Company; Thomas Schuster, Metropolitan Life Insurance Company

agreed that ratios in the 98 percent to 102 percent range—typical historically—are very comfortable for wrap issuers.

Wrap capacity for 403(b) plans: Schuster said the challenge to wrap providers interested in the 403(b) market is the minimum non-forfeiture rate that applies to those plans. "In a very low interest-rate environment, like the one we're in, that one percent guarantee with an annual rate reset presents some challenges to a wrap provider," Schuster said. "My belief is that if interest rates were to rise and that one percent non-forfeiture rate could be safely met, there would be more interest in pursuing 403(b) opportunities."

A smaller community of wrap providers: While stable value wrap capacity has been improving for several years now, there still are not as many wrap issuers as there were before the credit crisis. But there are more than there were at the market's bottom. "We love the fact that there's more choice now," said Standish Mellon's Barry. "The way I characterize it for our clients is there was a period of time when our portfolio managers had one option, and that was the option to put money to work that day. Today we have choice, which is a wonderful thing to bring to our clients and our portfolios. We love the fact that there are new competitors in this marketplace and that we can diversify portfolios broadly."

Tighter investment guidelines: permanent or temporary? Invesco's LeLaurin said his firm views the tightening of investment guidelines in the wake of the 2008 credit crisis as a temporary phenomenon. "Maybe guideline allowances were just too liberal for a while, and now we've reined in the outliers," he said. "We don't anticipate there will be new investment restrictions, and hopefully going forward we'll be able to manage in a way that produces the best results for clients."

"Portfolios have changed," added Mohan, "and (those changes) are here to stay, with a stricter compliance network, for the time being. If there is pushback, wrap providers will respond, but I don't think we're going to go back to (riskier) asset classes or concentrations we saw in 2008."

Schuster said he also thinks the more explicit investment guidelines now in place are "here to stay for the foreseeable future." But he added that his firm is willing to liberalize investment guidelines if an asset manager it's hiring as a sub-advisor can demonstrate capabilities in a given sector of the marketplace, such as collateralized mortgage securities or asset-backed securities.

Longer put provisions: While some pooled stable value funds have been lengthening the standard 12-month put—the notice period a

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plan must give before exiting the fund—Howe said he's not sure that it's a trend. However, he said, funds that stick with a 12-month put may find themselves forced to maintain a shorter duration in their investment portfolios and accept additional investment restrictions. Schuster noted that, all other things being equal, his firm will wrap a greater percentage of a pooled fund with a 24-month put than it will for one with a 12-month put. Matt Gleason, managing director of Dwight Asset Management Co., said his firm decided to stick with the 12-month put in its book of business. "We didn't want to give up liquidity beyond that 12-month period," he said. Barry said Standish Mellon made the same decision, as it was not convinced that much more wrap capacity would be available if it extended the put period. LeLaurin said his company, which operates several pooled funds, concluded that a 24-month put could benefit its plan sponsor clients by providing greater protection for retirement plan participants who stay in the fund. Many of its clients adopted a 24-month put with little pushback, he said, although a few did exercise their right to leave Invesco funds rather than adopt the longer 24-month put.

Stable value's role during decumulation phase of retirement: Roundtable participants as a group weren't certain what role stable value will play as retirement plan participants segue into the decumulation phase of investing—withdrawing, rather than accumulating, assets. However, LeLaurin observed that some retirement plan record-keepers have the ability to send regular monthly payments to plan participants once they are ready to begin making withdrawals, and, he said, "stable value could be the conservative, non-volatile asset from which those withdrawals are taken."

Outlook for stable value funds: Investment professionals generally agree that with interest rates near historic lows, rates have almost nowhere to go but up once the economy regains full steam. But the 2013 SVIA Fall Forum panelists said plan sponsors shouldn't be overly concerned about the impact on stable value funds. LeLaurin noted that stable value funds were designed to cope with rising rates, and that the effects of even a rapid rise in rates would likely be transitory. Howe noted that a rising rate environment could send market-value-to-book-value ratios for stable value funds below 100 percent for a time, but said this, too, is normal and manageable. Schuster agreed, noting that the stable value crediting rate mechanisms amortize investment gains or losses over time, cushioning investors from sudden market moves. And Mohan observed that rising interest rates can be negative for other asset classes too, so that singling out stable value funds for worry probably doesn't make much sense. SVIA

Stable value roundtable discussion at the Fall Forum 2013.
From the left: Angelo Auriemma, Plan Sponsor Advisors; Douglas Barry, Standish Mellon Asset Management; Matt Gleason, Dwight Asset Management; Stephen LeLaurin, Invesco; Jessica Mohan, Bank of Tokyo-Mitsubishi UFJ Ltd.; Warren Howe, Metropolitan Life Insurance Company; Thomas Schuster, Metropolitan Life Insurance Company

Building an Optimal Investment Lineup for a Defined Contribution Plan

By Randy Myers

Are you a plan sponsor or consultant looking to create a great investment lineup for a defined contribution plan? David Blanchett, head of retirement research for Morningstar Investment Management, offers this advice: Don't start with a goal of building the best lineup possible. Instead, start with your end point in mind: building the lineup that will give your plan participants the best opportunity for success. Why? Because every participant population is different, and what's best for one group of participants may not be best for another. Their education levels, engagement in the investment process and their experience with investing should all factor into your decisions.

Easier said than done, right? Well, yes. But there are some fundamental guidelines to follow no matter what your participant demographics and circumstances may be, Blanchett said in a presentation at the 2013 SVIA Fall Forum.

Morningstar helps build investment lineups for all types of plan sponsors, Blanchett said, and in each case it starts with the basics required to comply with Section 404(c) of the Employee Retirement Income Security Act, which requires that plan sponsors offer at least three different, diversified investment options with materially different risk and return characteristics. At a minimum, Blanchett said, this means offering a cash option, a stock option, and a bond option. In plans that it designs, he added, Morningstar almost always includes at least five options: a cash fund, a bond fund, a large-cap stock fund, a small-cap stock fund, and a foreign stock fund.

Morningstar will often include investment options beyond those basics, Blanchett noted, but he cautioned sponsors to think carefully before adding too many investment choices to their

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