## Capacity in Stable Value Industry Up Significantly for Second Straight Year

*By Randy Myers*

For the second straight year, the stable value industry has the capacity to take on a significant amount of new business—a welcome turnaround from conditions that prevailed in the immediate aftermath of the 2008 credit crisis.

In 2012, the industry absorbed $66 billion in new business, according to data compiled by LIMRA, an insurance industry trade group, and the SVIA, slightly outpacing the $60 billion in new capacity that a poll of stable value providers had indicated would be available.

This year, a survey by the SVIA found that providers expect to have net new capacity of $103 billion in 2013, including $15 billion from new entrants into the marketplace. To put those numbers into perspective, the SVIA calculates that total assets in stable value funds reached $701 billion last year.

Speaking at the 2013 SVIA Spring Seminar, Marijn Smit, president of Transamerica Stable Value Solutions, said the March 2013 survey drew responses from 27 of the 30 stable value issuers polled, including six banks. Of the 27 who did respond, 23 were existing issuers, and four were potential new entrants to the market, including three insurance companies and one bank. The existing issuers had $435 billion in stable value balances as of December 31, 2012.

Whether the industry is able to put all its available capacity to work will depend on demand from retirement plan sponsors for stable value funds, of course, but it also could be impacted by market developments. The issues most likely to inhibit providers from putting their capacity to use, survey respondents said, would be the absence of an equity wash rule in plans that have competing funds, funds with market-value-to-book-value ratios below par, and unattractive duration limits on funds and their underlying investments.

Phil Maffei, a senior director with TIAA-CREF, told Spring Seminar participants that his company has added capacity by providing a bundled offering, meaning that TIAA-CREF not only provides the wrap contract but also manages, through an affiliate, the underlying investment portfolio. It took in its first deposit in May 2012.

Maffei said the single biggest issue TIAA-CREF had to overcome in entering the wrap side of the stable value business was simply coming to

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## The Evolving Definition of Competing Funds

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you're telling me and you're putting me in front of a client, typically the conversation doesn't go well," he said. By way of example, he said it would be difficult for him to defend a request to classify a TIPS fund with a 9-year duration as a competing fund. "Some sponsors are fairly sophisticated investors; they might run their own bond portfolios," he explained. "When you try to tell them a long-duration TIPS fund is a competing fund, they're not buying it."

Gilmore noted that plan sponsors are sensitive to competing-fund restrictions, especially when the fund in question has been in a sponsor's plan for some time without any restrictions. "Every time a new fund is declared competing, that's another event requiring the sponsor to go in front of a committee and explain it," she said. "And they're making more of these trips, on many different subjects."

"We can help by being more consistent on definitions of competing funds," seconded Grove.

Bradie Barr, senior vice president-marketing for Transamerica Stable Value Solutions and moderator of the panel discussion, asked if there were risk mitigation tools that might be more palatable to plan sponsors and plan participants than an equity wash. Gilmore was not sure. "A lot of plan sponsors are used to the equity wash now," she said. "We did some brainstorming internally and a lot of the alternatives we brought up were more restrictive than an equity wash. We had started thinking about trading restrictions when market value is below book value for stable value funds, or imposing some type of fee for going to a competing option. But I think those just create more complications and concerns. So I do not know that there's an easy answer to the question."

"From my perspective as a manager, choice for sponsors is always good, especially for our separate account clients," Luna offered. He said one option the industry might consider is increasing the cash buffer in a stable value fund in lieu of imposing an equity wash. That would shorten the duration of the underlying portfolio, make additional funds available to meet redemptions if plan participants tried to arbitrage stable value and competing funds, and help protect wrap issuers. It would, in effect, quantify for sponsors the "cost" of an equity wash. "Clients appreciate a quantitative approach and choice," he said. "It may not be the solution for everybody, and as an investment manager I may not be a big fan of it, but some sponsors may feel it's more appropriate for their participants." Assuming a fund had a strong market-value-to-book-value ratio, Luna said, a bigger cash buffer could be a "fairly easy" solution.

Grove was hesitant to endorse the cash buffer solution, saying it might be difficult to come up with an industry standard for how big cash buffers should be. "A good thing about an equity wash is that there is a common understanding and acceptance of it," he said. And, he added, it effectively provides two protections. First, it forces plan participants to put their money at risk for some period of time—usually 90 days—if they want to engage in interest-rate arbitrage. Second, by the time that period has passed, the arbitrage opportunity may have passed, too.

Pellegrino said one way the industry can minimize controversy over competing-fund restrictions is to work with plan sponsors when they are setting up plans to make sure there are no competing funds in the investment lineup right from the start. "That way, we don't have to go back and have other conversations after the plan lineup is set up," he said. SVIA

## Understanding the Insurance Side of Stable Value

*By Randy Myers*

Insurance companies may have years of experience with stable value, but an ever-changing regulatory environment means the business itself has never become routine.

Unlike many other industries subject to government oversight, the insurance industry is regulated primarily at the state level rather than the federal level. Each state insurance department brings a slightly different approach to the task, and that can sometimes slow the process of bringing new insurance products to market.

"Fifty states means 50 different regulatory agencies," observed Bill Sample, director and actuary for Metropolitan Life Insurance Co., speaking as part of a panel discussion about the insurance market at the 2013 SVIA Spring Seminar. "Sometimes they work together, sometimes they don't."

There may be some relief in sight. Forty-one states have adopted the "Interstate Insurance Product Regulation Compact," which is designed to speed up the approval process for life, annuity, disability and long-term-care insurance products by establishing a single point of filing for review. Three more states are expected to adopt it by the end of this year, according to Helen Napoli, director of contract and product development for stable value investments at New York Life Investment Management LLC, who organized the panel. Unfortunately, neither New York nor California—two of the more challenging states from a regulatory perspective—are among the current or anticipated adopters. What's more, Napoli cautioned, the compact will not provide complete regulatory relief for insurers, since it will only address contract basics. "It won't change reserve requirements or other basic requirements a state may have," she said. She also noted that the compact has yet to write standards for the group annuity business, which would cover stable value contracts. "Still," she said, "it's something to look forward to."

In the meantime, insurers participating in the stable value market must gain approval not only from any state where they are licensed and plan to issue their contracts, but also, in some cases, from their home state—even if they do not plan on issuing contracts there.

The required filings can be voluminous, including a plan of operations, a contract form, a memorandum of variability, and an actuarial memorandum. Among the dozens of factors regulators examine, said Michael Rant, vice president and corporate counsel for Prudential Financial, are the core terms of the contract and the commitments made by the insurance company in that contract. The dual aim of the review, he said, is to protect consumers and the solvency of the insurance company.

In the case of stable value products, regulators also review which types of investments are eligible to be held in a stable value product, and how the crediting rate will be calculated. They make sure there are provisions for the insurer to terminate the contract if doing so should become prudent. To protect themselves, state insurance departments also make sure nothing is in a contract that could be construed as a waiver of remedies in the event of an insurer's insolvency. They also confirm that contracts are being issued to groups eligible to participate in stable value products under each state's insurance code.

Rant noted that the contract form contains "brackets" that delineate variable text, or language that may vary from contract to contract. The memorandum of variability requires an

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grips with moving from spread-based products—i.e., traditional GICs—to a fee-based product.

Jessica Mohan, director of the stable value product group for Bank of Tokyo Mitsubishi, UFJ, Ltd., said her company is in the second year of a three-year commitment to provide $30 billion of capacity to the stable value marketplace, having done just shy of $9 billion of business in the first year. "We have a mandate to grow to $18 billion by the end of September, and I think we'll make it," she said. "I also think our ability to grow to our ultimate level is achievable."

William McCloskey, vice president of the stable value market group at Prudential Financial, said his firm's total stable value capacity broached the $100 billion mark by year-end 2012, including $60 billion in its institutional, or wrap business. "We remain open with capacity today," he said, "although there are obviously ongoing discussions inside Prudential about how far we should go."

McCloskey said Prudential has been "very thoughtful about the type of business we've done, even though we've grown very rapidly."

More broadly, McCloskey said the additional capacity now available in the stable value market is healthy, creating more competition and allowing stable value managers to be more thoughtful and deliberate about meeting their fiduciary responsibilities. "It's also allowing plan sponsors to feel that the overall stable value market is not quite so out of balance," he said. "It's not in a state of turmoil; that's a thing of the past. The market has returned to a much healthier place."

Nick Gage, senior director with stable value manager Galliard Capital Management, also endorsed the competition brought on by more capacity, but said he still sees the current environment as an issuer's market. "They (issuers) all have their unique requirements," he said. "I think the challenge is for managers to find the right capacity."

That's particularly true for pooled fund managers, said Tim Stumpff, president of Morley Financial Services, noting that of all the estimated available new capacity this year, only 6 percent is earmarked for pooled funds. By contrast, 77 percent is earmarked for synthetic GIC funds (excluding pooled synthetic GICs). Those numbers, he said, led him to wonder if there is too much similar capacity chasing too few funds.

The panelists generally agreed that the increased capacity may make stable value issuers slightly more flexible about contract terms, but that they do not expect any dramatic changes. SVIA