STABLE VALUE EXIT PROVISIONS

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STABLE VALUE INVESTMENT ASSOCIATION

Stable value is a unique asset class available only in corporate and governmental tax-qualified defined contribution plans, as well as some tuition assistance plans. When offered as an investment option in such a plan, stable value seeks to offer capital preservation, liquidity, and returns typically higher than other options focused on capital preservation, such as money market funds. Stable value investment options may be offered by investment managers, trust companies, or insurance companies in various structures, such as separately managed accounts, commingled funds or guaranteed insurance accounts. Sometimes a stable value investment option will be managed by a plan sponsor. While stable value investment options may be managed or structured in a variety of ways, the important similarity is the use of stable value investment contracts, issued by banks, insurance companies, and other financial institutions, which convey to the investment option the ability to carry certain assets at book value. These investment contracts are what enable a stable value investment option to maintain principal value and minimize return volatility.

ABOUT THE ASSOCIATION

Established in 1990, The Stable Value Investment Association is a non-profit organization dedicated to educating retirement plan sponsors and the public about the importance of saving for retirement and the contribution stable value can make toward a financially secure retirement.

Today, the Stable Value Investment Association is one of the leading authorities on retirement investing. Its membership represents all segments of the stable value investment community including public and private plan sponsors, insurance companies, banks, and investment managers and consultants. The association serves as a forum for the exchange of ideas and discussion of issues important to the stable value industry, and provides leadership and representation before the media, educators, regulators, and opinion leaders.

STABLE VALUE EXIT PROVISIONS

Stable value products are designed to provide principal protection as well as returns over the long term consistent with short to intermediate term bonds for plan participants. Stable value products invest in fixed income investments and purchase insurance to wrap the investments. That insurance allows for contract value accounting and a stable net asset value (NAV).

Stable value products are benefit responsive meaning participants withdraw their original deposit amount plus accrued interest, which is called contract value at any time. When participant withdrawals occur as a result of a plan sponsor-initiated event such as re-enrollments, manager changes, divestures, and terminations, they may not be covered by the stable value contract. These events are subject to certain exit provisions, which are outlined in the contract. This paper broadly explores exit provisions.

WHAT ARE EXIT PROVISIONS?

Exit provisions are stipulated in the contract between the stable value contract issuer and plan. Exit provisions generally require the plan sponsor to wait a stated period before receiving the full benefit responsive value (principal plus accumulated interest). If a plan sponsor does not wish to wait, the sponsor can redeem stable value assets immediately at current market value, which may be less than the benefit responsiveness of the stable value product and may result in plan participants not having their principal preserved, which is a core investment objective of stable value.

WHY ARE EXIT PROVISIONS REQUIRED FOR PLAN SPONSOR-INITIATED WITHDRAWALS BUT NOT PARTICIPANT WITHDRAWALS?

Stable value products are designed to provide same-day liquidity for participant-initiated withdrawals. However, the underlying assets supporting benefit responsiveness are invested in securities with an average duration of two to three years for individually managed and pooled funds and almost six years for insurance company general and separate accounts.[1] When interest rates rise, the market value of the longer duration securities may fall below the benefit responsiveness promised to participants. In most stable value products, this is known as the market-to-contract value ratio. When the market-to-contract value ratio falls below 100 percent, the insurance company, bank, or other financial institution that issued the stable value contract stands ready to provide participants with benefit responsiveness for participant-initiated actions, which is their full invested balance (principal plus accumulated interest).

Without exit provisions, the portfolio would have to hold a significant amount of cash or cash equivalents to offset the potential for large withdrawals generated by sponsor decisions, which would result in a much lower return to participants. As a result, contract issuers require planned redemption schedules for plan sponsor-initiated withdrawals. Hence, the exit provisions. The exit provisions allow the contract issuer to manage these risks while ensuring benefit responsiveness for most participant withdrawals.

ARE ALL EXIT PROVISIONS THE SAME?

Exit provisions vary by stable value product type, but generally follow the longer the duration, the longer the waiting period. Below is a table summarizing the different exit provisions in the marketplace.

Stable Value Product Type	Average Duration[1]	Exit Provisions
Individually Managed Accounts	2.98	Initially set equal to the duration of the underlying assets, but may continue to extend until the market-to-contract value ratio equals 100 percent
Managed Pooled Funds	2.70	Generally, twelve months (i.e. "twelve-month put") but may go up to 36 months
Insurance Separate Accounts	5.89	Varies from three to six years; may also require structured payout over multiple years
Insurance General Accounts		Varies from three months to ten years; may also require structured payout over multiple years

THE BOTTOM LINE

As with all investments, stable value products have tradeoffs. Changes need to be thoughtfully considered and implemented in consideration of the best long-term interests of plan participants.

ENDNOTES

1. SVIA 1Q2019 Quarterly Characteristics Survey