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Stable value and the retirement tier

Executive summary

- Many plan sponsors want to provide sustainable retirement income solutions. This comes with challenges regarding asset retention, cost management, and educating participants.
- Creating a retirement tier out of existing funds is an efficient way for plan sponsors to build an in-plan retirement income menu without the administrative burden and oversight of new solutions.
- Stable value products, already available within most plans, are an effective component of a retirement tier for both short- and mid-term spending needs as they seek to offer guaranteed principal preservation, daily participant liquidity, and steady returns.

Introduction

While retirement income is a multi-faceted and complex issue that many retirement plan service providers are attempting to address through the development of new and untested products, plan sponsors should recognize that stable value is a retirement income tool already available to retirees exclusively within their retirement plans. Through plan design and communication, retirees can seek to take advantage of this tool as part of their overall retirement income solution.

What is stable value?

Stable value refers to a low-risk asset class that is designed to ensure principal preservation and participant liquidity while providing steady, positive returns. It is available exclusively in tax-qualified, defined contribution savings plans, such as 401(k) retirement savings plans, 403(b) plans, and 529 education savings plans. Although the structure and investments within stable value products can vary, they all share a key feature — the guarantee of a participant's principal plus accrued interest from banks and/or insurance companies. Like a bond fund, stable value products are able to generate returns by harvesting term, credit, and convexity risk premiums. However, a key differentiator is that these products are able to do so without the day-to-day volatility a bond fund experiences. This volatility muting mechanism is achieved through the use of contractual crediting rates that permit plan participants to transact at contract value instead of market value, a feature known as benefit-responsiveness. Through these features, stable value contracts provide day-to-day principal preservation with long-term rates of return consistent with those of intermediate bonds. And because they provide bond-like returns with very low return volatility, stable value products aim to offer investors a very attractive risk/return profile.

Importantly, stable value products have a long track record of success. Since their inclusion in defined contribution plans through various market cycles starting in the 1970s, they have consistently met their objectives of principal preservation and steady returns. During periods of economic uncertainty, such as in 2022, when both equity and fixed income assets experienced significant declines, stable value products lived up to their name, demonstrating their capacity to maintain stability and protect capital.

What is the retirement tier?

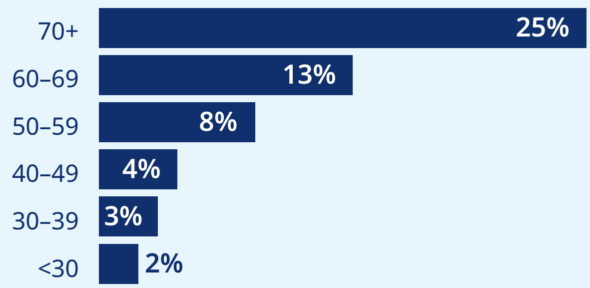
Over the past decade, plan sponsors have considered establishing retirement income menus or tiers — specific investments aimed at meeting the decumulation needs of retirees. This has involved an assessment of the many existing and new products that have come to market in recent years. While many of the new solutions are promising, some are complex and largely untested, presenting potential risks for retirees and communication and educational challenges for plan sponsors. From a broad plan design perspective (plan features and investments), there are likely some important components of retirement income solutions already present in most plans. It is important not to overlook the tools that are already available (or easily made available) when determining what retirement-focused investment products may be added to a plan. One primary consideration from a plan design perspective is making certain that retirement plans, which have historically focused on accumulation, are tweaked to allow for decumulation. This means making an income stream accessible to retirees by seeking to ensure that the plan offers a broad variety of withdrawal options supported by the plan administrator, such as systematic withdrawals or partial distributions.

Many of the income-oriented investment products coming to the institutional defined contribution market incorporate annuities. While these may have a place in retiree toolkits, they can be complex, expensive, and illiquid. Stable value products give participants the ability to utilize some percentage of their retirement portfolio like a bank savings account/CD, and perhaps automate a monthly distribution where plan design permits. Whereas participants outside the plan are likely to use a money market fund for liquid capital preservation, participants within the plan can utilize stable value products as their capital preservation tool for near-term expenses. This allows participants within the plan to recognize a potential long-term yield advantage that could make a significant difference over time. Some participants will understand how this works and implement it on their own. Others, however, may use an advisor or service to automate the process. In both cases, the majority will likely need some degree of education.

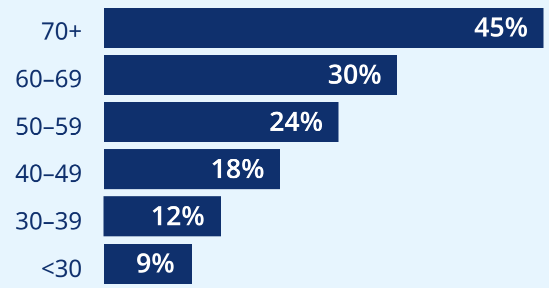
How is stable value currently being used?

As plan sponsors navigate the complexities of retirement income, understanding how existing tools like stable value products are currently being utilized can provide valuable insights. According to a 2021 study by the Stable Value Investment Association (SVIA), which analyzed data from recordkeepers representing 26.6 million participants from 2010 to 2019, nearly 85% of stable value assets were held by participants aged 50 and older.[1]

Average Asset Allocation to Stable Value by Age Group
(2010 - 2019)



Percentage of Participants Investing in Stable Value by Age Group
(2010 - 2019)



Source: SVIA 2021 Recordkeeper Survey

This may indicate that a significant block of retirees are already leveraging stable value as a decumulation vehicle, even without targeted guidance suggesting this course of action. The higher utilization of stable value among older cohorts can be attributed to its role in typical bucketing strategies, where retirees allocate funds across different “buckets” or time horizons. In such strategies, stable value often serves as the most conservative option, providing a buffer against market volatility and seeking to ensure liquidity for near-term spending needs. The consistent returns and principal preservation potentially offered by stable value products could make them an ideal choice for retirees seeking to protect their savings from market fluctuations while seeking to ensure steady income.

1. Source: Stablevalue.org; SVIA 2021 Recordkeeper Survey; https://www.stablevalue.org/who-invests-in-stable-value-and-why/

Stable value products have become an integral component in various managed investment strategies due to their historical ability to deliver steady returns with exceptionally low volatility. Many custom target-date funds incorporate stable value in their glidepaths, favoring them over short- or intermediate-term bonds and money market funds.

Managed accounts also frequently utilize stable value to aiming to provide a more reliable income stream for retirees. Even 529 education savings plans are leveraging stable value in their custom target funds, using 100% stable value allocations during the withdrawal phase to help balance return potential with reduced risk.[2]

2. Source: Stablevalue.org; Stable Value Providers See Opportunity in Growing 529 Plan Market. (2024). Stable Times. https://www.stablevalue.org/stable-value-providers-see-opportunity-in-growing-529-plan-market/

How can stable value be used for retirement?

Many financial professionals believe that 'bucketing' assets can be an effective component of an individual's overall retirement planning. Under this approach, an individual's savings are segmented based on their short-, mid-, and long-term spending needs and financial goals.

While the number of buckets and timing of spending varies by individual, a common feature of the bucket approach is to set aside a portion of savings in a highly liquid and market-insensitive investment to meet upcoming spending needs, such as those in the next 0–5 years. Stable value fits the role of holding assets that might be needed for mid-, short-, or near-term spending needs.

Not only can stable value help insulate an individual's assets from down market movements, but stable value is also generally expected to yield a higher return than other principal-preservation options, such as money market funds, and a more predictable return than unwrapped short-duration bonds.

When creating a retirement income tier in a defined contribution plan menu, plan sponsors may want to segment the investment options available to participants, as shown in the example on the next page. Stable value can play an integral role in meeting a participant's short- and mid-term spending needs.

For Retirees and Near-Retirement Employees

	Fund	Potential Benefit
Short-Term Spending	**ABC Stable Value Fund**	This fund aims to protect the invested principal and seeks a steady return typically in excess of a money market fund. This investment may be appropriate to meet unexpected or short- or near-term spending needs (such as a portion of living expenses expected over the next 0–5 years).
	ABC Target Date series w/ Annuity	A portion of the balance in target date series can be annuitized. The annuity payment can be utilized to meet short-, mid- and/or long-term spending needs.
Mid-Term Spending	**ABC Stable Value Fund**	This fund aims to protect the invested principal and seeks a steady return typically in excess of a money market fund. This investment may be appropriate to meet unexpected or short- or near-term spending needs (such as a portion of living expenses expected over the next 0–5 years).
	XYZ Short Duration Bond Fund	May be appropriate to meet mid-term spending needs (such as those from 3–5 years). This fund can lose principal.
	ABC Target Date series w/ Annuity	A portion of the balance in target date series can be annuitized. The annuity payment can be utilized to meet short-, mid- and/or long-term spending needs.
Long-Term Spending	XYZ Growth Fund	May be appropriate to achieve long-term appreciation of principal. This fund can lose principal.
	ABC Target Date series w/ Annuity	A portion of the balance in target date series can be annuitized. The annuity payment can be utilized to meet short-, mid- and/or long-term spending needs.

Source: Mercer, for illustrative purposes only. The investment options shown in the above table are for illustrative purposes only and should not be construed as a recommendation. Mercer and SVIA recommend that the appropriateness of investment options and other services and tools offered in a plan be evaluated on a plan specific basis.

Plan sponsors can guide the participants near and in retirement about the investments available for them in the investment menu. An example is shown below.

Do It For Me

Target Date Series

- ABC 2070 Target Date Fund w/ Annuity
- ABC 2065 Target Date Fund w/ Annuity
- ABC 2060 Target Date Fund w/ Annuity
- ABC 2055 Target Date Fund w/ Annuity
- ABC 2050 Target Date Fund w/ Annuity
- ABC 2045 Target Date Fund w/ Annuity
- ABC 2040 Target Date Fund w/ Annuity
- ABC 2035 Target Date Fund w/ Annuity
- ABC 2030 Target Date Fund w/ Annuity
- ABC 2025 Target Date Fund w/ Annuity
- ABC Retirement Target Date Fund w/ Annuity

Managed Accounts

Guide Me

Guaranteed Principal Plus Income

- ABC Stable Value Fund

U.S. Equity Funds

- U.S. All Cap Index
- U.S. Small Cap Index
- U.S. Small Cap Core Active

International Equity Funds

- World Ex. U.S. All Cap Index
- World Ex. U.S. All Cap Active

Core Bond Funds

- Bloomberg U.S. Aggregate Bond Index

For Retirees and Near-Retirement Employees

Guaranteed Principal Plus Income

- ABC Stable Value Fund

Guaranteed Income

- ABC Retirement Target Date Fund w/ Annuity
- Standalone annuities

Managed Accounts

Retirement Income Tools & Resources

- Retirement planning/projection tools
- Social Security optimization
- Partial withdrawals

Financial Advice

- Financial Coaching
- Educational Services

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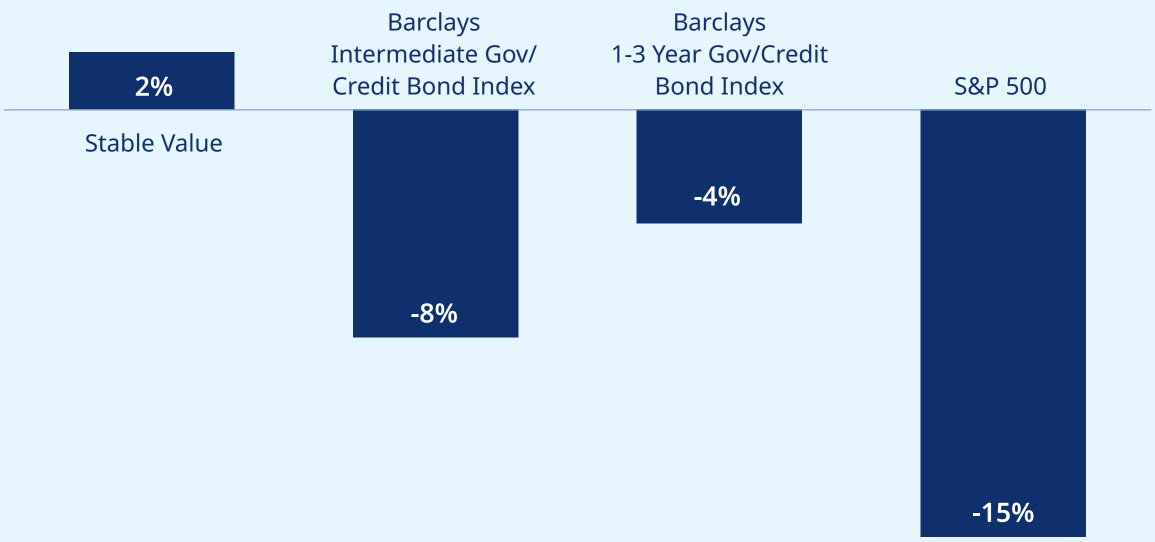
When considering stable value for the retirement tier, one important feature is its low correlation to other asset classes. 'Sequence of return' risk is more relevant to participants nearing retirement because near-term returns have a magnified impact on their ability to achieve their retirement goals. The market environment of 2022, which was characterized by substantial losses in both equity and fixed income assets, exposed the limitations of relying solely on fixed income to lower volatility and reduce risk as exemplified in traditional 60/40 portfolios.

Traditionally seen as a stabilizing force within diversified portfolios, fixed income investments failed to provide the expected downside mitigation in 2022 amid rising interest rates and inflationary pressures.

This dual decline underscored the need for alternative strategies, like stable value products, that can potentially offer consistent returns and principal preservation even when traditional asset classes falter.

2022 Average Annual Returns by Asset Class



Source: SVIA 1Q2024 Quarterly Characteristics Survey

When examining optimal portfolio returns in a 2018 article published by MDPI, titled “Stable Value Funds Performance[3]”, it was found that for investors with significant risk aversion, such as those in or near retirement, including stable value products in their portfolios not only boosted average returns but also lowered volatility more effectively than any other asset class.

One of the key differentiators of stable value products, and a simplicity not to be overlooked, is their convenience. Most defined contribution plans already include stable value as an investment option, eliminating the need for plan sponsors to add new products or introduce additional complexities to their retirement offerings. Unlike new or specialized retirement income investment products, which may require complex administrative setups and extensive participant education, stable value is easily integrated into a plan sponsor’s retirement income menu. This simplicity reduces the administrative burden on plan sponsors, allowing them to focus resources on education and improving participant outcomes rather than navigating the complexities of new product offerings.

Additionally, from the participant’s standpoint, stable value products are relatively straightforward compared to other retirement income options. Products like annuities often involve complex terms, potential liquidity restrictions, and decisions that are difficult to reverse. In contrast, stable value products seek to provide daily liquidity and predictable returns, without requiring participants to make complex financial decisions or commit to long-term contracts. This straightforward nature can help participants manage their retirement funds more easily, with the flexibility to adjust their strategies as their needs change.

When managed account solutions are incorporated into a retirement plan, automating the retirement tier and bucketing strategy with stable value becomes highly convenient for participants. Because stable value products are already included in the plan’s investment lineup, their managed account can automatically allocate funds to stable value based on the participant’s age or retirement timeline without the need to source new products. This approach allows for a seamless, personalized strategy that aligns with the participant’s retirement goals, aiming to provide stability and predictable income through automated adjustments, without requiring participants to manually adjust their allocations.

3. Source: MDPI.com; https://www.mdpi.com/2227-9091/6/1/12

Conclusion

The challenge of providing sustainable retirement income has become a critical issue for plan sponsors. With concerns over inadequate savings, the need to maintain assets within institutional retirement plans, and the complexity of educating participants on effective decumulation strategies, plan sponsors must find solutions that address both the financial needs of retirees and the practicalities of plan management.

- By creating a dedicated segment of the retirement plan focused on decumulation, plan sponsors can offer targeted investment options that meet the specific needs of participants nearing or in retirement.
- Within this framework, stable value products can play an integral role: stable value is one of the only products that seeks to combine a guarantee of principal with full participant liquidity, making it a potentially effective and flexible tool for retirement income.
- Stable value products aim to provide the stability and liquidity necessary to manage near-term expenses and the consistent returns necessary for mid-term growth, making them a natural fit for bucketing strategies and other decumulation approaches.
- By incorporating stable value products, plan sponsors can deliver a familiar, straightforward option that aligns with both participant needs and fiduciary responsibilities while avoiding the administrative and educational burden of adding new products.

Incorporating stable value into a retirement tier not only addresses the immediate challenge of providing secure retirement income, it also offers a solution that is convenient, cost-effective, and easy to implement. This integration is designed to help participants achieve better financial outcomes by offering a stable source of income and mitigating market volatility, ultimately supporting a more secure and confident retirement.

Authors

Stable Value Investment Association

Andrew Erman, FSA, CFA
Senior Vice President of Stable Value Solutions Inc., Transamerica
SVIA Board Member

Kara Marr, CPA
Vice President Stable Value Marketing, RGA
SVIA Communications Committee

Nick Gage, CFA
Senior Principal, Galliard Capital Management, LLC
Immediate Past Chair of the SVIA Board of Directors

Zach Gieske
President, Stable Value Investment Association

Mercer

Angelo Auriemma, CFA
Principal, Director – Investment Consulting
Mercer

Austin Roberds
Principal, Director – Investment Consulting
Mercer

Preet Prashar, CFA
Principal, Director of Defined Contribution Strategic Research Teams
Mercer

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