SVIA STABLE TIMES

The publication of the Stable Value Investment Association Volume 19, Issue 1 • First Half 2015

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Stable Value's Contribution to the American Dream

By Randy Myers

The core mission of the stable value industry is a simple one: help retirement plan participants grow their nest eggs with minimal risk. In doing that, says James King, chairman of the Stable Value Investment Association, the industry is helping millions of working Americans pursue the American Dream: work hard, save, retire well.

That's not a bad reason to go to work each day, and at the SVIA's 2015 Spring Seminar, King encouraged attendees to be proud of the work their industry is doing.

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Ron Suskind: U.S. Voters Face "Dynastic Dilemma"

By Randy Myers

In sports, Americans are familiar with many dynasties. The New York Yankees, winners of 29 pennants from 1921 through 1964. The Montreal Canadiens, who took 20 Stanley Cups between 1930 and 1979. The UCLA Bruins, who won 10 NCAA basketball titles from 1964 to 1975.

In presidential politics, it's been a different story. We are, after all, the country that split from England and its dynastic tradition. But now, in the space of roughly one generation, a third Bush (Jeb) and a second Clinton (Hillary) are running for president.

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SVIA Survey Shows Wrap Capacity Continuing to Grow

By Randy Myers

The great wrap capacity shortage increasingly looks like a distant memory.

Following the financial turmoil of 2008, a number of financial institutions stopped underwriting wrap contracts for stable value funds, limiting the industry's growth prospects. Over the past several years, though, a number of new issuers have entered the market and some veteran players have increased their appetite for new business. The result? The market for stable value contracts is more diverse and capacity is far less constrained.

Here are the numbers: The industry had $77.5 billion in potential new capacity in 2012. It had $103.5 billion in 2013, $87.8 billion in 2014, and, based on an SVIA survey, looks to have $79 billion this year, says Marijn Smit, president, Investment Solutions, Transamerica Investments & Retirement.

Participating in a roundtable discussion of industry trends at the 2015 SVIA Spring Seminar, Smit noted that it isn't uncommon for some potential wrap capacity to go unused. In 2012 the industry took on $27.0 billion in new business, and in 2013 it added $48.8 billion. Those amounts represented less than one-third and one-half of the available new capacity, respectively, in those years. In 2014 the industry didn't need any of its available new capacity as stable value assets held steady, although many funds took the opportunity to further diversify the number of wrap providers used. The latest data came from an SVIA survey conducted in March 2015. The survey drew responses from 22 issuers with $488 billion in product balances at year-end 2014. That was down from $544 billion a year earlier, but the decline was primarily due to a large issuer who participated in the 2014 survey not reporting data this year.

Stable Value's Contribution to the American Dream

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During the financial crisis that erupted in 2007, he noted, participants in defined contribution plans suffered market losses in excess of $1 trillion, but the stable value asset class held strong. The steady performance delivered by stable value funds hasn't been lost on millennials, he said, many of whom now allocate a portion of their retirement savings to stable value funds, or on baby boomers, who saw how stable value can help protect their savings from market volatility. "We are the pillow that participants use to sleep on at night, knowing their savings are growing and staying safe," King said.

Partly as a consequence, King said, assets in stable value funds grew significantly between 2007 and 2013, to more than $720 billion, even after the Department of Labor declined to include them on a list of "qualified default investment alternatives." King also observed that stable value funds not only performed well through the financial crisis but also have performed well over longer periods of time. A recent analysis by Prudential Financial's Stable Value Markets Group, where King serves as managing director and senior client portfolio manager, found that from 1990 through 2014 stable value funds generated average annual returns of 4.48 percent, while money market funds, typically viewed as their principal competition, averaged returns of just 2.04 percent, while inflation ran at 2.42 percent.

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Ron Suskind: U.S. Voters Face "Dynastic Dilemma"

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Should one of them win and hold office for the customary two terms, it would mean those two families had controlled the White House for 28 of 36 years.

"I call it the dynastic dilemma," Ron Suskind, Pulitzer Prize-winning journalist with The Wall Street Journal and a senior fellow at Harvard University's Center for Ethics, said at the 2015 SVIA Spring Seminar in April. "We have two dynasties going head to head." While some people are saying "not them again," Suskind noted, "in some ways it actually might work out, depending on how clear-thinking they are."

He also noted that most presidential elections wind up being determined by economic conditions. If the economy is strong leading up to the election, the incumbent party tends to win. If it is weak, the challengers tend to prevail.
- Ron Suskind

In the tendentious and highly partisan political environment we're in right now, Suskind said, "clear thinking" will require that the candidates be careful with what he called their "Nixon in China" moments. It was a reference to President Richard Nixon's decision to visit China in 1972, a shocking move by the staunch anti-Communist that paved the way for normalized relations between the U.S. and China. Nixon's authority to act, and the impact of his actions, were grounded in his long opposition to Communism.

"He was moving against type," Suskind said. "Watch for that. Because the key to this election, if it's Bush and Clinton, is who manages their 'Nixons in China' better? You only get a couple of them."

Suskind observed that former President Bill Clinton, who nurtured a reputation for helping the working class, found his "Nixon in China" moment when he undertook reform of the federal welfare program. The question now, he said, is what those Nixon-in-China moments will be for the latest Bush and Clinton candidates. "Think about the array of policies that each of them might attempt," he said. "That's why I'm a little hopeful about this election. Plus, they have ownership of almost all the issues that have unfolded over the past 30 years."

If pressed to make an early prediction on how a Bush versus Clinton race might shake out, Suskind guessed that Bush would win after Republican strategists dredged up some "friends of Bill Clinton … ticking bombs" that would damage Hillary Clinton's campaign late in the race. But he acknowledged that he could be wrong, and that there are other candidates with compelling stories who may yet capture their party's favor. He mentioned Wisconsin Governor Scott Walker and U.S. Senator Marco Rubio of Florida among the Republicans, and U.S. Senator Elizabeth Warren of Massachusetts among the Democrats, although Warren has repeatedly said she is not running for president in 2016.

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"Fall 2016," he concluded, "could be fireworks."

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SVIA Steps Up Outreach Efforts

By Randy Myers

More news is good news.

Over the past year, the SVIA has expanded its social media presence while continuing to reach out to the press and regulators to promote the industry and educate them about its products. As part of that effort, says Marijn Smit, president of Investment Solutions at Transamerica Investments & Retirement and also chairman of the SVIA Membership Committee, the association has sought to inject stable value into the broader retirement conversation. One way it did that was by linking promotions to America Saves Week. The association also launched a series of stable value expert interviews that were made available on the SVIA YouTube channel and promoted via Twitter and other social media channels.

Smit joined Nick Gage, senior director at Galliard Capital Management Inc. and Sue Graef, head of the SVIA Data and Research Committee, in outlining the association's outreach efforts during a presentation at the SVIA Spring Forum in April.

Gage said one of the press highlights over the past year was the debut of a new resource, "A Guide to Stable Value Funds for Pension Plan Sponsors and Advisors," produced by the SVIA in collaboration with the Bloomberg BNA Benefits Practice Resource Center. The SVIA also participated in the production of an educational video series in collaboration with Plansponsor.com, and hosted a "Stable Value Masterclass" on both Asset TV, a Web-based video communications site for investment professionals, and the SVIA website. In June 2015, Gage added, Kiplinger magazine is scheduled to publish an article about stable value funds.

As part of its outreach efforts, Gage said, the SVIA also surveyed the stable value user community to find out which types of information they would like to see on stable value fund fact sheets. Among the data points listed as crucial by the vast majority of respondents were the identity of the fund advisor, the identity of the contract provider or providers, the inception date of the fund, the fund's investment objective, a description of the fund, the fund's yield or crediting rate, the total expense ratio, and the average duration of the fund's underlying investment portfolio.

"The next step in this process is to take these results, summarize them, and determine if we can come to an agreement on one or two industry-acceptable templates (for fund fact sheets) that we think would be appropriate," Gage said. "Then as an association we could go to information providers and say, 'Look, this is what we're providing today, and

Stable Value Regulatory Agenda Inches Forward

By Randy Myers

The stable value industry will have to wait a bit longer to find out if its products are subject to regulation under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

The Dodd-Frank Act charged the Securities and Exchange Commission and the Commodity Futures Trading Commission with determining whether stable value contracts should be subject to the same new regulations that would apply to financial swaps. The study, originally scheduled to be completed by 2011, is still unfinished. Steve Kolocotronis, vice president and associate general counsel for Fidelity Investments, said at the 2015 SVIA Spring Seminar that with more pressing matters on their plates it's hard to predict when regulators might complete it. But he reminded seminar participants that until regulators do act, wrap contracts continue to fall outside the purview of Dodd-Frank.

In part because the study process has taken so long, Kolocotronis and other members of the SVIA met with CFTC staff earlier in the year to provide them with additional background on the issue. The information session seemed appropriate, Kolocotronis said, since there has been a fair amount of turnover among CFTC staff since Dodd-Frank was passed.

Kolocotronis also reported that the U.S. Government Accountability Office, at the request of since-retired Congressman George Miller of California, recently undertook a study of qualified default investment alternatives, or QDIAs, within defined contribution retirement plans. A principal aim of the study, which has not yet been published, is to determine whether target-date funds are performing as intended under the QDIA framework. "Our hope is that the GAO comes back with something that, in the best of all possible worlds, says that stable value should be a QDIA," Kolocotronis said. "Maybe something more reasonable would be an age-based QDIA where, when you get to a certain age, it's okay to use stable value as a QDIA." He noted that the DOL, which wrote the QDIA guidelines, has been responsive in the past to GAO studies. "If the GAO does come out with something that is positive for stable value, our hope is the DOL will look at that seriously," he said. He added that the GAO report is scheduled to be released by the end of this year.

While stable value funds may not have become subject to any new regulations in the past year, Kolocotronis said, money market funds have. Among other things, the new rules allow money market funds to impose redemption fees, or to temporarily suspend redemptions, if they experience a liquidity crunch. Also some money market funds will be required to have a floating net asset value. All this has prompted some defined contribution retirement plans to replace their money market funds with stable value funds, Kolocotronis said. He predicted that more will follow suit. "I'm not sure it will be a flood of money," he said, "but there will be some."

Cash Flow, Interest Rates and Stable Value Products

By Randy Myers

The long-anticipated rise in interest rates may finally be at hand.

Wall Street—and the stable value community—spent much of the past few years anticipating an uptick in interest rates that never materialized. But last year the Federal Reserve ended the bond-buying program it had been using to keep a lid on long-term rates, and later this year it is widely expected to start pushing short-term rates higher. Once again, retirement plan sponsors and consultants are wondering what the impact will be on stable value funds.

The short answer is that the impact will likely be modest. In the near term, rising rates could lead to some declines in stable value funds' underlying investment portfolios, which could drop the market value of those portfolios below their book value. But LeAnn Bickel, head of stable value contract administration for Invesco Advisors Inc., notes that many stable value providers have had experience with market-to-book ratios falling below par without major consequences. "We know it's a function of the mechanics of the product, and not that big of a deal since market-to-book ratios are typically fluid," she said, kicking off a roundtable discussion of the issue at the 2015 SVIA Spring Seminar.

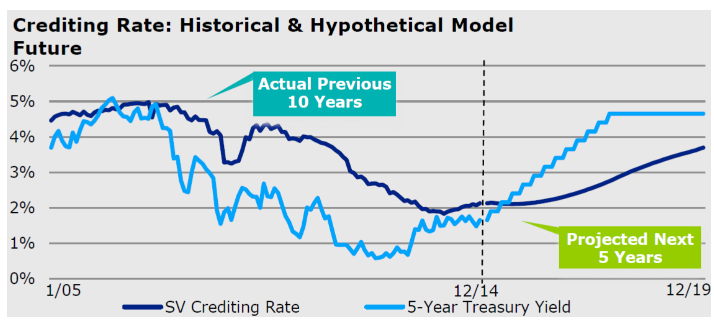
Bickel noted that one potentially complicating factor in the current environment is that many stable value funds have been experiencing flat or negative cash flows as participants become increasingly comfortable with channeling more of their money into the stock market, which has been in an uptrend for the past six years. How might stable value funds be impacted if cash flows remained negative in a rising rate environment?

Timothy Grove, vice president-retirement with Prudential Financial, said it would not be surprising to see stable value crediting rates decline if there are net or participant withdrawals when market value is below book value. "And while we all expect rates to go up—and that's the closest I'll come to making a prediction—we don't know when," he cautioned. "We've thought that for a number of years now, and it hasn't happened."

To shed some light on how stable value managers might work through a rising-rate environment, Grove explained how Prudential manages its evergreen general account stable value products.

"Our general account product strives, of course, to generate competitive crediting rates for plan participants," Grove said. "Otherwise, we're not going to have money to manage." But he said Prudential also works hard to manage liquidity so that it can meet cash flow needs, and pays close attention to the responsiveness of its products to changes in interest rates, money market yields, and competitors' spot-rate products. "We also, at the end of the day, want to have a profitable product, so we're trying to figure out the right investment strategy to be all of those things," he said. "What we've landed on is essentially a laddered-maturity portfolio that consists of a meaningful allocation to commercial mortgages and private placements." Having a laddered portfolio of investments, he said, means that Prudential always has a significant amount of money maturing at book value to help meet liquidity needs. Or, he added, that money also can be used to reinvest in new securities, which can help Prudential keep pace with interest rates in a rising-rate environment.

Michael Leonberger, portfolio manager with Invesco Advisors Inc., noted that stable value portfolios in general have grown more conservative since the 2008 financial crisis and should now be more responsive to interest-rate changes than they were in the past. He shared a graph showing how stable value crediting rates might respond, hypothetically, if the yield on five-year Treasury bonds shoots up 25 basis points every quarter for the next three years. After holding above five-year Treasury yields for the past decade, crediting rates would lag as interest rates turned up, the analysis showed. At the same time, market value-to-book value ratios for stable value funds would fall below 100 percent for a couple of years—to about 95 percent—before starting to climb back up.



> *"It's worked in all market cycles and all interest rate environments, and I think stable value is set to continue doing that in the future."*

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Cash Flow, Interest Rates and Stable Value Products

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Asked if he was concerned about interest rates continuing at their current lows for a long period of time, Thomas Schuster, vice president, stable value investment products for MetLife, reminded seminar participants that stable value funds appeal to conservative investors who typically are more concerned with safety of principal than maximizing returns. "If the prevailing interest rate environment is lower," he said, "it's going to be lower for the alternatives, as well. I still believe stable value produces superior outcomes over other alternatives. We're still in a good spot, but I do think we'll experience additional negative cash flows." He encouraged plan sponsors, wrap providers and stable value managers to take a long-term view of stable value, and said he would be concerned if a low-rate environment prompted stable value managers to embrace riskier investment strategies in search of yield. "Regardless of the interest-rate environment, there's a need to take that long-term view and manage the portfolios appropriately," he said.

All the panelists agreed that it also is important to manage expectations of plan sponsors and plan participants.

"Stable value provides principal preservation for participants transacting at book value and a steady, stable rate of return," Bickel summarized. "It's worked in all market cycles and all interest rate environments, and I think stable value is set to continue doing that in the future."

Goldman Sachs' Swell Highlights Risks, Opportunities for Stable Value Managers

By Randy Myers

Some risks are obvious, others not so much.

The Federal Reserve is expected to start raising short-term interest rates later this year, and everybody recognizes that rising rates present some risk for stable value portfolios, in part because they can reduce the value of the fixed-income securities held in the typical stable value investment portfolio. But what about agency mortgage-backed securities? They're among the risks stable value managers are facing this year, too, according to Michael Swell, managing director and co-head of Global Portfolio Management for the Global Fixed Income team at Goldman Sachs Asset Management.

The risk associated with agency mortgages may not be as obvious as interest-rate risk, but it is real, Swell said during an address to the 2015 SVIA Spring Seminar in mid-April. He explained that the issue isn't default risk but rather the "significant embedded optionality that in a rising rate environment could cause a stable value portfolio, a short-duration portfolio, to extend meaningfully in duration." Swell said that if rising rates resulted in a significant slowdown in prepayments of agency mortgages, 30-year mortgage pass-throughs could go from having a three- or four-year average life to seven or maybe even 10 years. As a result, stable value managers could experience greater-than-anticipated market losses in their investment portfolios.

Swell also commented that other sectors of the fixed-income markets look more appealing. He said that Goldman Sachs Asset Management remains constructive on commercial mortgage-backed securities, in both agency and private-label sectors. Collateralized loan obligations represent an attractive return-per-unit-of-risk for bank buyers, he added, and FFELP Student Loan asset-backed securities present attractive spreads for a high-quality security. Swell remarked that in general the economic environment is favorable for credit right now, with investment-grade credit offering wider-than average spreads over Treasuries of about 125 basis points. "We think credit has the potential to get expensive," he said, "but it's not right now."Turning to the broader investing climate, Swell said that overall global economic growth has improved, with the U.S. continuing to grow at a moderate pace and Europe reviving, although growth in China has slowed and Greece's debt woes are back on the front page. Both of the latter factors are threats to global economic stability.

Swell said the apparent slowdown in U.S. economic growth in the first quarter may have been driven by severe winter weather and will likely prove temporary. "We will probably see something like 1 percent growth in the first quarter, but we expect it to pick up meaningfully in the second and third quarters," he said.

Although inflation remains subdued in the U.S., thanks in part to low oil prices, Swell said there is evidence that wage pressures are building, which could help convince the Fed to begin raising interest rates later this year. He said current low oil prices are a net positive for the U.S. economy over the long term. While difficult for energy companies and those that cater to them, low oil prices allow consumers to spend less on fueling their cars and heating their homes and more on other goods and services. "We expect to see retail sales pick up as a result of the effective tax cut consumers have received in the form of lower oil prices," Swell said.

Swell said that even though the Fed appears to be on track to start raising short-term interest rates in 2015, it will probably wait until September to do so, thanks to, among other things, the strong U.S. dollar, slowing momentum in the U.S. economy, soft economic conditions in a number of other countries, and modest levels of inflation in just about all developed economies. He said that against that backdrop the Fed isn't likely to be overly aggressive when it does start to push interest rates higher. Moderate rate increases aren't as troublesome for the stable value industry as sharp rate increases, and over time can lead to higher crediting rates for stable value investors.

ERISA Issues: Proposed Rules, Regulatory Initiatives and Litigation

By Randy Myers

Retirement plan providers can be forgiven if they sometimes feel they have a target on their backs. These days, it could actually be two.

"Service providers, including stable value providers, are prime targets for both the Department of Labor and the plaintiffs' bar," said Jeremy Blumenfeld, partner and co-chair of the ERISA litigation practice at the law firm of Morgan, Lewis & Bockius LLP, during a presentation at the 2015 SVIA Spring Seminar in Key Biscayne, Florida.

Since fiscal 2013, Blumenfeld said, the DOL has been looking into fiduciary service providers under a National Enforcement Project aimed at uncovering improper or undisclosed compensation received by benefit plan consultants and investment advisors. The DOL referred 161 investigations for litigation in fiscal 2014, although no data is available to indicate how many of those were service provider cases.

Meanwhile, plaintiffs' attorneys are targeting stable value providers in class-action lawsuits that typically allege either that a stable value fund was imprudently selected as an investment option for a retirement plan, underperformed a stable value benchmark, or charged excessive fees.

In the performance-related cases, Blumenfeld said, plaintiffs' attorneys often compare a stable value fund's performance—unfairly, in his view—to that of the Hueler Analytics Stable Value Pooled Fund Comparative Universe. That's an average of 15 different stable value funds, and by definition, he pointed out, there will always be some funds that underperform it.

In fee-related cases, one common argument from plaintiffs' attorneys is that service providers shouldn't have been able to charge what they charged because they were fiduciaries with respect to the plan, and, in effect, should have negotiated with themselves to charge a lower fee. Courts have largely rejected that argument, Blumenfeld said, but he warned that "in litigation, a lot depends on the specific judge you're faced with. It can be a close call."

In a closely watched case filed in 2001 a firm recently agreed to settle for $140 million. The lawsuit centered on revenue-sharing practices and alleged that the firm had used high-cost outside mutual funds in the defined contribution plans it managed in order to maximize "undisclosed kickbacks."

Blumenfeld said it's not uncommon for service providers to view the settlement of such lawsuits as a cost of doing business. "I was not a defense lawyer in that case, but as somebody who's been monitoring that case for years, there is nothing I saw that was specific to the firm that suggested they did anything bad that anybody else in the industry doesn't do," he said. "They were just a target at the wrong place at the wrong time, with mostly I think the wrong judge who was deciding some of these issues. It might be that at the end of the day the firm would have won that case. But I'm also confident the plaintiffs had experts that articulated damages theories that were many multiples of $140 million."

Blumenfeld said service providers who want to minimize their litigation risk may want to consider aligning their products and services with what others in the industry are doing to avoid being singled out by the plaintiffs' bar, even though that runs counter to conventional wisdom contending that companies should seek to distinguish themselves from their competitors.

He said that in contract negotiations, stable value providers also might want to fight for less rather than more discretion in providing services to their clients, which could further minimize their risk. "I'm not saying litigation should be driving business decisions," he said, "but these are important things to consider."

While courts continue to weigh in on how service providers should be treating their clients, regulators have been fairly quiet recently. Michael Richman, who serves as counsel in the employee benefits and executive compensation practice at Morgan, Lewis & Bockius, said service providers are still waiting, for example, for final regulations from the Department of Labor on how to create a guide to the disclosures they make to plan sponsors under ERISA Section 408(b)(2). The DOL is expected to hold focus groups this fall to discuss the issue.

Elsewhere, Richman said, the DOL:

- *Has refined its Rule 404a-5 disclosure rules for plan participants to say that those disclosures must be provided at least once every 14 months rather than every 365 days.*

- *Has been asking service providers, as part of the DOL's National Enforcement Project, for copies of their 408(b)(2) and 404a-5 disclosures, although it is not clear exactly what the department is doing with them.*

- *Is continuing to look into whether it should require additional disclosures from service providers about self-directed brokerage windows in defined contribution plans.*

- *Appears to be closing in on new rules that will define what constitutes investment advice as it relates to determining fiduciary status under ERISA.*

Consultants Share Perspectives on Stable Value

By Randy Myers

Given the important role that retirement plan consultants play in product selection and plan design, it's no surprise that participants at the 2015 SVIA Spring Seminar were eager to hear what a panel of plan consultants had to say about stable value funds—what they like about them, what concerns them. The panelists included Jay Dinunzio, senior consultant with Aon Hewitt Retirement and Investment; Rod Bare, senior vice president in the Fund Sponsor Consulting group at Callan Associates; Jeffrey Stein, vice president and senior research analyst at Morgan Stanley Wealth Management, Investment Products and Services; and Scott Matheson, defined contribution practice leader, CAPTRUST Financial Advisors.

Vetting stable value providers

Bare kicked off the discussion by answering a question about how his firm vets stable value providers. Callan begins, he said, by looking at the structure and stability of the provider's organization and its commitment to the stable value business. Callan also reviews the provider's stable value strategy, the design of its fund, investment and wrap capacities, and the historical performance of the funds. Callan reviews the provider's investment and portfolio management process, including the selection and oversight processes for any external managers it may use. It looks at the provider's wrap negotiation process and how well it has been able to negotiate investment management guidelines that are reasonable for plan sponsors. It also looks at the experience of the provider's stable value team and any external portfolio managers it might use. Finally, Callan looks at the proposed fund structure itself, including details about fees, liquidity, disclosure support, participant communication and education assistance, and how the manager would handle the transition of assets from the prior provider's fund, where applicable.

At CAPTRUST, said Matheson, analysis of stable value providers has become much more detailed since the 2008 credit crisis. "Our approach became return of capital first and foremost," he explained. "What is the safety of the investments, and the quality of any guarantees around the portfolio?"

CAPTRUST now sends questionnaires to stable value providers every quarter to understand the quality of their portfolios and how they've been performing. The company also is having conversations with providers about wrap contracts, in terms of both their cost and their access to wrap capacity, although the latter is less of an issue these days than it was a few years ago. It also strives to understand the degree to which wrap contract provisions limit a stable value manager's ability to take advantage of investment opportunities.

Helping clients understand stable value

Educating plan sponsors and plan participants about stable value funds has always been a challenge and a responsibility for plan providers and plan consultants. To make the complexity of stable value funds easier for plan sponsors to understand, Morgan Stanley's Stein said he'd recently developed a formal buy-side research process for stable value funds under which his firm publishes reports covering all of the issues outlined by his fellow panelists. At the end of each report is a section covering the characteristics of the stable value option being reviewed, concisely spelling out the provisions a plan sponsor must follow if it wants to make an investment in the fund.

Stein said he's also developed a simple decision tree that features high level questions plan sponsors can answer to determine how they might want to incorporate a stable value fund into their retirement savings plan, and which type of fund might be most appropriate for them. "The answers put you into one of three buckets—a collective trust bucket, an insurance company separate account bucket or a general account bucket. All the products are good, and all have their pros and cons. The decision comes down to the risk tolerance of the plan sponsor, and what's best for their plan participants."

Because stable value products tend to have less transparency than many other investment options used in defined contribution plans, Stein said that Morgan Stanley also has developed a presentation that allows clients to compare multiple stable value funds. "It's a way to look at liquidity provisions, competing fund provisions, performance, assets under management, wrap providers, and ratings for guarantors," he said. "It's a powerful tool for conducting searches."

Stable value versus money market funds

Matheson said stable value providers could try to capture some of the market share held by money market funds by continuing to improve the knowledge base from which plan consultants work, in part by creating stable value fund fact sheets that are easy to understand. He noted that while just about everybody in the retirement market knows what a money market fund is, not everybody understands stable value funds.

Rising interest rates

Stein said his firm has been telling plan sponsor clients that unless there is an extreme inversion of the yield curve, which Morgan Stanley isn't anticipating, stable value investors ultimately would benefit if interest rates start to rise. As older investments in the stable value portfolio mature or are sold, he said, funds would be able to replace them with higher-yielding assets, and that eventually would boost crediting rates. "All the products I look at in the collective fund space are positioned for a rate increase," he added, "so the damage should be mitigated when it starts."

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Custom target-date funds

As target-date funds have become increasingly popular investment options within defined contribution plans, the stable value community has been keen to find ways to be included in them. Off-the-shelf target-date mutual funds made up strictly of other mutual funds aren't an option, but the custom target-date funds some larger plans build from their own investment lineups can accommodate a stable value component

Stein said Morgan Stanley has developed custom target-date models that do include stable value and has found it useful for its clients. Dinunzio said that while he isn't involved in target-date consulting, he could imagine stable value making sense for conservative target-date funds.

Bare observed that it is generally up to a target-date fund's glide-path manager to decide whether to include a stable value component. However, he argued that the benefits of stable value's book-value accounting protocol aren't as useful inside a target-date structure as they are in stable value funds themselves. "I haven't seen a clear-cut case yet for using stable value inside a target-date fund, but I would think this is an opportunity for your group to do some of that homework, make some case studies, put that out there, and make the case clearer," he said. Matheson warned that the costs of stable value funds would be a complicating factor, since in his observations most target-date funds have lower expense ratios than stable value funds.

New opportunities for stable value

Asked where stable value providers might find new opportunities beyond the defined contribution retirement plan market, Matheson and Dinunzio both said they could see stable value playing a role in lifetime income solutions for retirement plan participants. "It's not a slam dunk in terms of how you would adapt the products," Dinunzio said. "But if you look at some of the products being developed for that marketplace, they start to look and feel a little like stable value in that you have an asset manager running an asset portfolio in combination with an insurance component. That to me seems to be an opportunity."

Reenrollment of retirement plan participants

Although the practice is hardly widespread, a number of plan sponsors have embraced the idea of periodically re-enrolling their employees in their retirement savings plans. Individual participants may opt out if they wish, but the practice usually boosts participation levels. It also creates concern for stable value managers, since employees who don't designate how their contributions to the plan should be invested are typically defaulted into a qualified default investment alternative—a target-date fund, balanced fund or a managed account. To the extent their accounts were previously invested in a stable value fund, this can result in significant outflows of cash from the stable value fund.

Bare said his firm has done several reenrollments for plan sponsor clients and recommends the exercise. "It gets a lot of participants who appear to be misallocated into a reasonable allocation," he said. "But it also gives them the chance to opt out. For folks who still want to be in stable value, that is wonderful; there is an opportunity for them to stay there."

Bare also said research has shown that participants are at an inflection point when they retire, and he suggested there's a case to be made for parking their retirement account balances in a stable value product when they stop working so they can sort out what they want to do with their money without having their principal at risk. "Reenrollment is a good thing, I think it's healthy," he said. "But I don't think it undercuts the case for stable value." SVIA

Stable Value: The Plan Sponsor Perspective

By Randy Myers

It's obvious that many defined contribution retirement plan sponsors like stable value funds—about half include them among their plan's investment options.

But some plan sponsors really like stable value funds.

Take Keith Watson, director of pension investments for Textron Inc. "Stable value is complicated," Watson says. "There are operational risks, wrap capacity and fee issues, participant communications, a whole host of things that come with it. But it's a unique alternative that offers a valuable risk-return profile for our plan participants, and they can't get it anywhere else. There really is no true alternative to stable value."

Or consider Joe Fazzino, senior manager, pension investments, for United Technologies Corp. "We as an investment staff do believe that this is a gift that's been given to us, to be able to offer our participants par value liquidity, a competitive rate of return, you really cannot find anywhere else in the marketplace," Fazzino says. "So this is something we should continue to take advantage of, even though it may be a bit more burdensome than money market funds."

And then there's Garold Oliver, global pensions manager for Hallmark Cards. "Our approach is that nothing really competes with our stable income fund," he says. "Our view at Hallmark is that an allocation to stable value makes sense for everybody, regardless of their age."

Watson, Fazzino and Oliver made these comments during the 2015 SVIA Spring Seminar in Key Biscayne, Florida, where they were joined by Russell Smith, vice president and head of pension investments at Aetna Inc., in fielding questions about their views on, and experiences with, stable value funds. Here are additional highlights from their question-and-answer session:

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Stable Value: The Plan Sponsor Perspective

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Q: What common questions do you get from plan participants?

If you want to get the attention of retirement plan participants, it seems, just tell them one of their investments is earning less money. That's been the experience, anyway, of Hallmark's Oliver, who said that when stable value crediting rates start to fall, plan participants want to know why—although they don't express the same curiosity when crediting rates are going up.

Fazzino and Smith said common inquiries from their plan participants include questions about why expenses for stable value funds tend to be higher than expenses for other investment options in their plans, which are primarily low-cost index funds. Also, some Aetna and Textron retirees will call in, Smith and Watson added, if they think the daily investment returns posted on their plans' websites differ from what their own calculations indicate.

Q: Do you offer target-date funds, with or without a stable value component?

United Technologies introduced custom target-date funds to its investment lineup in 2009 but did not include a stable value component in them, Fazzino said, partly because that was a time when wrap issuers were making increasing demands on plan sponsors and stable value managers in response to the credit crisis. In that environment, some members of the plan's investment committee wanted to limit the ability of wrap issuers to impact other areas of the plan. "I think we might have missed an opportunity," Fazzino said, "but it's an opportunity we need to revisit because I think stable value does belong in target-date funds in some capacity. It is something we hope to work on in the near future."

Smith said that while the idea of having custom target-date funds with a stable value component has some appeal, Aetna's target-date funds use passively managed collective trusts with total expenses of just 8 basis points and include no stable value component. He added that the funds are primarily used by participants under the age of 40, and observed that "any kind of allocation model you would look at would not allocate too much to stable value. For us, it wouldn't have the bang for the buck."

Textron also uses passively managed target-date funds without a stable value component, Watson said. He noted, though, that the assets in those target-date funds have grown substantially over time. "We may be approaching that point where doing a custom fund is potentially a more viable option," he said. "I think there are still a lot of hurdles for us to make that happen. But if you have a custom target-date fund, stable value is potentially a good fit."

Q: What are the biggest administrative burdens associated with stable value?

Fazzino said managing a stable value fund's equity wash provisions is one of the biggest administrative burdens associated with stable value funds. He also cited the complexity of explaining wrap contracts to internal constituents such as human resources personnel, or simply explaining the stable value concept to plan participants. It also can be hard, he said, to explain why a wrap issuer needs to review communications to participants. But his company is addressing those challenges. After United Technologies had difficulty finding a good source for a standardized stable value fact sheet it would be comfortable sending to participants, Fazzino said, the company partnered with research firm Morningstar to create a custom fact sheet. The company also added a link on its fact sheet to the SVIA website, so that plan participants can take advantage of the many educational materials that can be found there.

Q: What are your views on reenrollment, and have you done one?

All four panelists said their firms had not reenrolled employees in their retirement savings plans, and had no plans to do so. "We think there's lots of fiduciary risk with reenrollment," Fazzino said.

Q: How do you choose a stable value manager?

Watson said Textron, the most recent of the four companies to engage in a manager search, handled the process without the assistance of a consultant. It relied instead on its own experience and knowledge plus insights from its peers, particularly fellow members of the Committee on Investment of Employee Benefit Assets, an organization that represents more than 100 of the country's largest pension funds. "We spent a lot of time talking (with them) about who the major players are (in the manager field) and what their strengths are," he said. In meeting with manager candidates, Watson said, his firm's focus was on all the factors typical of a manager search in any asset class, including the strength of the management company, its organization, its performance, its strategy and its philosophy. Beyond those factors, Watson said, Textron looked for a stable value partner who would be flexible, had expertise and relationships in the wrap market, and offered good reporting and analytics capabilities.

Smith said that in Aetna's last search for a manager it emphasized finding a strategic partner who thought as it did about the role of stable value and had the requisite expertise and resources. He said Aetna also sought out a manager who would be "willing to customize and work with us where we maybe thought a little differently than their typical template." Finally, he said, Aetna wanted a partner who could provide access to a diverse group of wrap providers.

Q: Do you get involved with selecting wrap providers?

Fazzino said United Technologies works closely with its stable value managers on selecting wrap issuers, and he advised other plan sponsors to do the same. "We really value the partnerships we have with our insurance companies," he said. "One thing I offer to other plan sponsors is try to get as close as you can to those insurance companies that wrap your funds because they do have a lot to offer, not only in stable value but also on other projects you may be working on. They are just a great resource for all of us."

DOL Proposes Major Changes to ERISA Fiduciary Rules for Providers

By Groom Law Group

The Department of Labor's (DOL) proposed fiduciary rules change the playing field for service providers that may make recommendations for the sale of their own products and services. If a service provider including a stable value product provider or an investment manager were to acquire fiduciary status in connection with sales of its own products or services, it could face a prohibited conflict of interest with respect to the receipt of compensation. This result may be avoidable if the Department of Labor's proposed exceptions can be used or an existing prohibited transaction exemption is in place. A brief summary of these provisions follows.

The Proposed Rule defines a person as an ERISA fiduciary if, for a fee or other compensation, the person provides one of following four types of advice ("Covered Advice") directly to a plan, plan fiduciary, participant or beneficiary under an agreement, arrangement or understanding that the advice is individualized to, or specifically directed to, the advice recipient for consideration in making investment or management decisions with respect to securities or other property--

• recommendations as to the advisability of acquiring, holding, disposing or exchanging securities or other property;

• recommendations as to the management of securities or other property;

• appraisals or fairness opinions concerning the value of securities or other property if made in connection with a specific transaction involving the plan; and

• recommendations of a person who will also receive a fee or other compensation for providing any of the three Covered Advice categories listed above.

The DOL also proposed several carve-outs that allow persons who may otherwise be deemed investment advice fiduciaries to avoid fiduciary status --

Counterparty Exceptions

The first "carve-out" category is referred to as the "Counterparty Exceptions." These sales exceptions allow a person, acting as or on behalf of a counterparty, to provide Covered Advice to an independent plan fiduciary in an arm's-length sale, purchase, loan or bilateral contract or proposal for such a transaction if certain other conditions are met, as follows.

A Counterparty Exception is available for transactions with plans represented by a fiduciary with responsibility for managing at least $100 million in employee benefit plan assets. A Counterparty Exception is also available for transactions with plans with 100 or more participants, but the adviser counterparty must obtain a written representation from the plan fiduciary that it exercises authority and control with respect to the management and disposition of plan and will not rely on the person to act in the best interest of the plan, to provide impartial investment advice, or to give advice in a fiduciary capacity. Notably, the Counterparty Exception does not exempt transactions with small plans (i.e., fewer than 100 participants) whose discretionary investment manager has less than $100 million in plan assets under management.

For any transaction to be covered by a Counterparty Exception, the adviser/counterparty must fairly inform the fiduciary representing the plan that the adviser/counterparty is not undertaking to provide impartial investment advice. Further, the adviser/counterparty may not receive any fee or other compensation directly from the plan or plan fiduciary for the provision of investment advice in connection with the transaction.

Appraisal Carve-Out

A person furnishing an appraisal or fairness opinion will not be deemed a fiduciary provided that the appraisal was rendered for (1) an investment fund which holds the assets of more than one unaffiliated plan; or (2) for purposes of complying with ERISA's reporting or disclosure requirements.

Platform Provider Carve-Out

The DOL carves-out from fiduciary status those who market and make available platforms for a plan fiduciary to select and monitor investment alternatives that are offered to participants and beneficiaries provided that the person acknowledges in writing that they are not providing investment advice to the plan. Moreover, in connection with those platform provider services, a platform provider may avoid fiduciary status if the person "merely identifies investment alternatives that meet objective criteria specified by the plan fiduciary (e.g., stated parameters concerning expense ratios, size of fund, type of asset, credit quality)"; or "merely provides objective financial data and comparisons with independent benchmarks to the plan fiduciary."

Investment Education Carve-Out

Lastly, the DOL also attempted to exclude from the definition of fiduciary advice the provision of investment education. Most notably, investment allocation models may not refer to a specific investment product available under the plan. This is a departure from current guidance that would allow asset allocation models to be populated with specific investment choices. Under the DOL's new approach asset allocation models would be populated with asset classes, and not specific investment choices, regardless of whether a disclaimer is included that specifically highlights that other investment options are available under the plan.

All service providers are encouraged to review the DOL regulations to determine how the proposed regulations may impact their business and to provide comments to the DOL by July 20, 2015.