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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Capacity in Stable Value Industry Up Significantly for Second Straight Year

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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

SVIA Finishes Annual Survey Covering 2012

By Gina Mitchell

SVIA's Annual Stable Value Investment and Policy Survey, its most comprehensive survey, confirmed the positive trends found in most defined contribution plan asset allocation and stable value investments surveys. The annual survey, which covers 38 stable value managers, reported that assets under management in 2012 had risen to $701 billion, which is up by 8.6 percent from 2011. Further, the annual survey found this increase was experienced by all three management segments: individually managed accounts, which generally cover large plans, grew by 2.9 percent, pooled funds, which generally cover small to mid-sized plans, grew by 0.8 percent, and life insurance company accounts, which cover all-sized plans with their product offerings, grew by 17 percent. Based on the annual survey, stable value comprised 14 percent of all defined contribution plan assets in 2012.

Plans and Assets Under Management	2012 Total	2011 Total	% Change
Stable value assets managed (millions)	$701,326	$645,554	8.6%
Number of plans	189,361	159,000	19.1%

Stable Value Contract Allocation	2012 Total	2011 Total	% Change
Cash or short-terms	5.72%	5.18%	10.5%
Traditional GICs/BICs	2.06%	4.64%	-55.6%
General Account IPG or similar vehicle	36.57%	37.71%	-3.0%
Wrapped buy & hold assets	0.25%	0.48%	-49.1%
Wrapped assets managed to a fixed horizon	1.37%	1.34%	2.0%
Wrapped actively managed evergreen assets	38.38%	44.16%	-13.1%
Assets with separate account wraps	9.38%	6.37%	47.4%
Market-valued assets	0.00%	0.00%	0.0%
Other	6.28%	0.12%	5229.0%

Duration and Credit Quality	2012 Total	2011 Total	% Change
Modified duration (years)	3.74	3.67	1.9%
Credit quality, S&P ratings	7.92	8.07	-1.8%
Credit quality, Moody's ratings	7.95	8.15	-2.4%

Plan assets in the survey were predominantly defined contribution plan assets with 401(k) at 55 percent, 457 plans at 8 percent, and 403(b) at 31 percent in 2012. The remaining 5.4 percent was comprised of other tax-deferred savings plans such as 529 tuition assistance plans, Taft-Hartley plans and defined contribution plans. Interestingly, 403(b) plans increased and 401(k) plans declined when compared to 2011 data. This can be attributed to the strong growth of the life insurance company accounts management sector as well as survey participation, since survey participants can vary from year to year.

The overall net return for stable value fell from 3.18 percent in 2011 to 2.97 percent in 2012, which reflects the declining interest rate environment. However, stable value returns still compare favorably to money market returns for the same period.

The annual survey reported similar trends as SVIA's Quarterly Characteristics Survey with respect to some metrics, but not all. The annual survey found that the credit quality of the underlying investments decreased overall with survey participants reporting AA or Aa2 or better on average using both S&P and Moody ratings, whereas the quarterly survey shows credit quality edging upwards towards AA+ or Aa1. The annual survey also found that duration had increased from 3.74 years in 2012 from 3.67 in 2011, and the quarterly survey reported a similar trend. The variations can be attributed to the fact that the annual survey covers both a larger and broader array of stable value products, whereas the quarterly survey covers 23 synthetic GIC stable value managers.

Types of Assets Invested in Stable Value	2012 Total	2011 Total	% Change
401(k)	55.39%	62.77%	-11.8%
457	8.56%	8.78%	-2.6%
403(b)	30.66%	20.66%	48.4%
529	1.61%	1.10%	45.7%
Taft Hartley	0.50%	2.27%	-77.8%
Defined Benefit	0.02%	1.66%	-98.6%
Other	3.26%	2.76%	18.2%

The annual survey found that the underlying portfolio allocation continued to vary based on the management segment. Overall the annual survey found that the average allocation in 2012 for stable value products was 5.7 percent in cash, 38.6 percent in GICs and general account products, as well as 49.4 percent in wrapped assets. SVIA

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insurer to spell out alternative or replacement language that could have a material effect on the risks being assumed by the insurer.

The actuarial form documents that the contract adheres to capital reserve requirements for the state, Sample said. It also provides space for an insurer's actuaries to sign off on the soundness of the product being reviewed, including, in the case of separate account stable value products, confirmation that risk charges being paid to the general account are adequate.

Insurers domiciled in New York, Sample said, also are required to file a self-support memorandum in which its actuaries attest that the contract is self-supporting under reasonable assumptions about interest rates, mortality and expenses. That memo also delves into multiple facets of the contract: product risks, risk mitigation provisions, pricing assumptions, anticipated investment returns, risk charges, expenses and profits. California has special requirements, too, he said, including a statement indicating why

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Fee Disclosure Remains a Work in Progress

By Randy Myers

In the year since federally mandated fee disclosure rules went into effect for defined contribution plans, this much has been discerned: plan sponsors think the new disclosures are helping them meet their fiduciary responsibilities. Also, some plan participants now know more about what their retirement investments are costing them.

Last summer, new federal regulations required plan service providers to disclose more information about fees, turnover ratios and performance benchmarks to retirement plan sponsors. Plan sponsors, in turn, were required to share some of that information with plan participants. Some began doing so even before the final deadline. For the past three years, the Stable Value Investment Association has been polling its members to see how they are meeting the disclosure requirements.

In a survey of 21 members in December 2012—14 stable value managers and 7 wrap issuers—the SVIA found that stable value structured as insurance company separate accounts had the lowest average expense ratio on a dollar-weighted basis—17 basis points—while pooled and collective funds had the highest at 41 basis points. Expense ratios for insurance company general accounts averaged 19 basis points on a weighted basis, while individually managed accounts averaged 30 basis points. Le Ann Bickel, manager of stable value client services for Invesco Advisors, noted that all of those expense ratios compared favorably with the expense ratios of most other investment options offered in defined contribution plans. She also observed that different providers may include different expenses in their disclosures; some might include recordkeeping fees, for example, while others may not.

There was a fairly high degree of consistency among providers in terms of which performance benchmark they were using for their stable value funds. By far, the benchmark most often used was the three-month U.S. Treasury bill index, used by 12 survey respondents. Three used a 1-3 year government/credit index, two used a 1-5 year government/credit index, one used the Barclays U.S. Intermediate Government/Credit Bond Index and one used the Barclays U.S. Intermediate Aggregate Bond Index.

One area where stable value providers do not have uniformity is fund turnover ratios. Jane Marie Petty, principal with Galliard Capital Management, said the methodologies used were diverse—six different techniques were cited.

While the industry may have more work to do to explain the differences in calculating turnover or moving to one methodology, the response of plan sponsors to the new fee disclosures has generally been favorable. In an Oppenheimer Funds survey reported in the February 2013 issue of *Plan Sponsor* magazine, plan sponsors said the new disclosures are helping them meet their fiduciary responsibilities, improving transparency, helping them understand the fees they pay relative to the services they receive, and helping them make more educated decisions about providers. Plan sponsors also said the new disclosures seem to be helping plan participants feel more educated about their plans, and are helping to build trust between participants and sponsors.

A survey of plan participants by LIMRA, an insurance industry trade group, also provided some encouraging findings. True, half the participants surveyed this year said they did not know if their retirement savings plans were costing them anything; that was the same percentage saying that in 2012 before the disclosure rules took effect. However, the number who said they thought there were no fees fell to 22 percent from 38 percent. Also, 28 percent of the participants surveyed in 2013 said they now know what their plan fees are, up from 12 percent in 2012.

In summary, plan participants now have access to more information. Increased fee transparency could ultimately lead to lower overall costs for plan participants, Bickel and Petty said. However, it's still the case that neither the average plan participant nor the majority of plan participants fully understand the fees they are being charged. Bickel and Petty encouraged stable value providers to continue working together to establish uniform disclosure practices, which they said would help to clarify and simplify their products for plan sponsors and plan participants.

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the product in question is not hazardous to the public.

"Once a contract is issued, regulators become increasingly focused on the reserves and the asset-liability match," Sample said. That's because they care about the financial stability, or solvency, of the insurance company. "They want to show policyholders—in this case, investors in a stable value fund—that they will receive their full benefit," he explained.

While insurance companies understand the focus on reserves, they also want to make sure reserve requirements are calculated appropriately. In New York, Sample said, reserve requirements for stable value products are calculated under New York Regulation 128. As a first step, it requires that insurers calculate the present value of their liability, project the guaranteed payout at the contract's minimum rate, and then discount that payout at 104.5 percent of Treasury spot rates. Then, in a second step, the company must apply the appropriate "shaves," or discounts, to the value of the assets held in the stable value fund's underlying portfolio. If the result in step 1 exceeds the result in step 2, the company must hold the difference as additional reserves.

Actuaries at the Life Insurance Council of New York, an insurance industry trade group, have proposed to New York regulators an alternate method for calculating reserves. The council suggests that its method would be more appropriate, especially during periods of market stress like those that existed during the 2008 credit crisis, when many separate account issuers were required to dramatically boost their reserves. The American Academy of Actuaries has made similar proposals to the National Association of Insurance Commissioners, Sample said. Its proposals would base the discount rate calculation on a blend of prevailing yields on Treasury bonds and investment-grade corporate bonds.