TRANSAMERICA®

EVALUATING GENERAL ACCOUNT STABLE VALUE OPTIONS IN RETIREMENT PLANS

Three simple keys

Stable value options are a great choice for plan participants who want to invest in something safe and — of course — stable. Typically the most conservative investment in a retirement plan, stable value options yield short- to intermediate-term bond-like returns, with the lower volatility typically associated with money market funds. For participants approaching retirement, conservative investors, those seeking to safeguard a portion of their retirement account, or those looking to further diversify their asset allocation, the guaranteed crediting rate (known as rate of return in other asset classes) is appealing.

Due to a variety of factors, stable value doesn't always get the attention it should. Stable value funds can be complicated and filled with jargon. They lack the flash and flare of other options on the retirement plan menu. And their crediting rates don't change as frequently as relative performance rankings of core investment options. After selecting a stable value fund based on a quick glance, advisors and plan fiduciaries may not look again — until it's time to replace them.

That's when the lack of attention can come back to bite. There's a better way to evaluate stable value options, especially those backed by insurance company general accounts, and that's what we'll cover in this paper.

For the avoidance of doubt, this white paper has not been prepared in conjunction with, nor specifically endorsed by, the Stable Value Investment Association; this link is provided for general informational purposes only.

https://www.stablevalue.org/glossary/

ONE: STABLE VALUE PRODUCT STRUCTURE

Stable value options can be delivered to plan participants in different structures. They generally fall into three types: those backed by insurance company general accounts, segregated insurance company separate accounts, or synthetic guaranteed investment contracts that are typically delivered in a collective investment trust (CIT) form. The main differences are highlighted here:

GENERAL ACCOUNT STABLE VALUE OPTIONS

In a general account option, deposits are invested alongside other assets of the issuing insurance company's general account. The option's crediting rate is set by the issuer, and the issuer may earn indirect compensation from the difference between the crediting rate provided to the contractholder and the earnings on the underlying investments. The obligation under general account products is backed by the claims-paying ability of the issuing insurance company.

SEPARATE ACCOUNT STABLE VALUE OPTIONS

In separate account stable value options, the assets are held in a separate account with the issuer. The securities are owned by the issuer, and the issuer or a third party manages the securities. The crediting rate is determined by the issuer or by a contractual formula, and the issuer receives either the spread between interest credited to the contractholder and earnings on the underlying investments, or a set fee. The obligation is backed by the securities in the separate account and by the claims-paying ability of the issuer.

SYNTHETIC GUARANTEED INVESTMENT CONTRACT (SYNTHETIC GIC)

The assets in a synthetic GIC structure are the contract itself and securities owned by the plan. The assets are managed by a third party. The crediting rate is based on a formula, and the issuer is compensated with an explicit fee. Obligations of the fund are backed by securities owned by the plan as well as the claims-paying ability of the issuer.

General account stable value options include a variety of unique contract features that can have financial consequences upon contract termination. Because it's important to understand them up front, we have focused this paper on general account stable value options.

ARE THERE FIDUCIARY CONCERNS?

While frequent reviews of a stable value investment are not a separate fiduciary obligation, plan fiduciaries must ensure a proper process for selecting, monitoring, or replacing any investment option in a qualified retirement plan. Advisors can deliver added value by making sure the investment committee reviews the stable value investment on a regular basis, as should also be done for other core investment options.

KEY: INCLUDE THE STABLE VALUE FUND IN THE FIDUCIARY'S INVESTMENT COMMITTEE MEETINGS

Because these options don't have performance volatility as seen with other core menu investment options, they tend to remain as options in fund line-ups for years, if not decades. The people involved in the original decision to invest — the advisor and the plan sponsor contact who initially signed the contract — have likely changed. Periodic reviews of the stable value option, at least once a year, should be on the plan fiduciary's investment committee's to-do list. This will ensure members understand it and can make an informed decision about whether it is still an appropriate choice for the plan. Advisors who suggest this to committee members add value to their clients, especially when they can help analyze the funds during times of market volatility, changing interest rate environments, or other economic conditions.

TWO: FINANCIAL STRENGTH RATINGS OF THE ISSUER

With a general account stable value option, the plan sponsor is buying an obligation of an insurance company, so it is important to understand the insurer's claims-paying ability. An insurer's financial strength ratings should not necessarily be the only factor in the decision. The contract offered by the issuer must also be considered, and we'll discuss those considerations later in this paper.

When buying an obligation of an insurance company, whether general account, separate account or synthetic GIC, it is important to review and monitor over time the insurer's claims-paying ability as evaluated by firms such as AM Best, Moody's, and Standard & Poor's. Remember, insurance companies are under extensive, ongoing scrutiny — much more than they were just 30 years ago. None of the highly rated insurance companies offering stable value investments today has failed to make good on its obligations, even in the aftermath of the financial crisis of 2007-2008.

You can review insurance company ratings at:

Moody's: moodys.com **S&P Global:** spglobal.com **AM Best:** ambest.com

KEY: UNDERSTAND THE FINANCIAL STRENGTH OF THE ISSUER

THREE: CONTRACT CONSIDERATIONS[1]

The crediting rate on a general account stable value option is guaranteed and is one factor in the retirement plan's decision to include it in the plan. But other factors can make a big difference in the stable value option's evaluation, especially when the time comes for the contract to change or terminate.

Here are some considerations before selecting a stable value option:

CREDITING RATE

Some contracts include **teaser rates**, good for a few months or a few years. This can result in lower rates when the teaser expires and continuing until the next crediting rate reset. Ultimately, a teaser rate may mean lower overall crediting rates, so be sure you understand what is being offered.

Consistency of crediting rates across clients should also be considered. Does the issuer credit higher rates for new customers than for existing customers? Issuers that offer portfolio rate options treat all customers the same, but portfolio rate options may not see crediting rates rise, or decline, as quickly as other crediting rate structures.

Stable value funds provide a crediting rate that won't drop below a certain level, or **floor**. Read the fine print and ask your representative to explain if there is a minimum guaranteed crediting rate, where it sits, and whether it could change over time. Some plan types *require* a minimum crediting rate above 0.00%, and others *may offer* one. It's important to understand if there is a minimum, and whether it extends for the life of contract or resets periodically.

Crediting **rates reset** on different schedules depending on the product and issuer. Although there may not be a "correct" schedule for everyone, buyers should know the schedule in their contract. The crediting rate may reset monthly, quarterly, semi-annually, or annually.

PARTICIPANT RESTRICTIONS

There is often a restriction on direct transfers from a stable value fund into another investment option that provides a similarly low risk profile, known as a competing fund. An "equity wash" rule requires participants to first transfer their money to a non-competing investment option for a period of time, typically 90 days, before transferring it back into the stable value fund. This restriction reduces the risk of arbitrage, thereby protecting participants and stable value fund returns over the long term. These rules may differ by stable value option and by product structure.

PLAN SPONSOR CONTRACT TERMINATION PROVISIONS

By reading this paper, you're becoming better informed about stable value options. That puts you among those who do their homework up front. It's frequently only on the back end that plan fiduciaries and advisors find out there are consequences for not knowing how their stable value fund works. Here are some features that may impact the ability to terminate the contract:

[1]Each stable value contract is governed by its own terms, which may be different than those described herein.

MARKET VALUE ADJUSTMENT (MVA)

An MVA is an adjustment to a stable value contract's value, typically due to a plan sponsor termination request and sometimes in response to employer-initiated or other market-related events. Not all stable value contracts include an MVA. It's important to know whether yours does because there are financial consequences — something fiduciaries sometimes learn the hard way.

There are typically two ways to terminate a stable value general account product: with or without an MVA. Most often, an MVA would apply in a rising interest-rate environment. In a low or declining interest-rate environment, most stable value general account options don't apply an MVA. In such cases, plan sponsors could terminate their stable value contract and receive 100% of the assets immediately and at book value, similar to other plan investments.

With rising interest rates, it's more typical for issuers to assess an MVA on stable value contracts. In some cases, you may find another insurer to assist the plan with the MVA by ensuring participant balances are not negatively impacted. However, this could have a negative impact on the new crediting rate or recordkeeping fees, so these solutions should be evaluated carefully and understood before buying.

BOOK VALUE INSTALLMENTS

In some situations, a plan sponsor may decide to receive book value payments over time and avoid an MVA upon termination. Often, this would be a payment upfront with five subsequent annual installments, for six payments over five years. Some modernized general account stable value contracts may allow for a shorter installment payment period.

CREDITING RATE IMPAIRMENT DURING CONTRACT TERMINATION

Some stable value general account options allow the issuing insurance company to reduce the crediting rate for contracts during their installment payout period. The crediting rate may be reduced, or impaired, by 1.00% or to 1.00%, as examples. Typically, the impairment is explicitly noted in the contract, giving sponsors and advisors another reason to review the contract closely.

PORTABILITY

From a fiduciary perspective, the ability to evaluate the recordkeeper and the stable value option separately is critical. If the plan sponsor decides to change recordkeepers, will the stable value option need to be terminated at the same time? It's important for plan fiduciaries to know the answer so they don't feel tied if the recordkeeper is not performing or the stable value option no longer works for them.

KEY: BE SURE YOU UNDERSTAND THE CONTRACT FEATURES BEFORE YOU BUY

Review how the contract addresses the crediting rate and termination rules, including whether an MVA will apply. You should also understand whether you can change recordkeepers without moving the investment — important from a fiduciary perspective.

CONCLUSION

Year after year, the stable value solution in the retirement plan fills a needed space among the plan's investments, crediting a modest return rate and not drawing much attention.

Then the day comes when a decision is made to terminate the stable value contract, and everyone finds out there is more to these options than just the crediting rate.

As leaders in stable value solutions for qualified plans, Transamerica encourages you to think differently about them. Do the homework upfront to make sure you understand how they work. Have questions? We can help.

Get in touch:

CALL
800-755-5801

VISIT
Transamerica.com

2396371R1 05/23

TRANSAMERICA®