



Viewing Stable Value With 2020 Vision

New roles for stable value emerge as the landscape evolves.

February 2020

KEY INSIGHTS

- Stable value investments in defined contribution (DC) plans are increasing amid growing demand for retirement income solutions.
- The capital preservation feature of this investment vehicle can be a useful building block in retirement portfolios.
- We believe stable value, which is only accessible through DC plans, will be critical as the industry and regulatory landscape evolves.

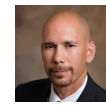
Several key provisions in the recently passed SECURE Act may likely support the central role defined contribution (DC) plans play in the retirement journey. The law pushes required minimum distributions out to age 72 from 70½, provides encouragement for participants to remain in their plans longer into retirement, and highlights the importance of retirement income-oriented solutions. Stable value plays a key role among workers moving nearer and into retirement (Figure 1). Our proprietary research reveals that an increasing majority of DC plan sponsors want participants to remain in their plans after retirement, and the numbers appear to bear this out as more DC plan participant assets are remaining in plans after workers vacate their jobs.

The culmination of these factors indicates that plans will develop portfolios for participants in which

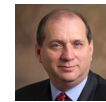
stable value has an anchor role. Stable value may have an important place through the retirement life cycle (Figure 2).

Evolution of Stable Value

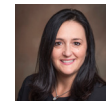
The stable value industry has evolved significantly in recent years. Earlier changes included the development of the synthetic investment contract after the bankruptcy of several guaranteed investment contract issuers in the 1990s. The passage of the Pension Protection Act of 2006 shifted plan sponsors' qualified default investment alternative preference to target date funds while slashing a dependable source of cash flows for stable value. More recently, 2016 money market reform was a positive development for stable value flows. The newly passed SECURE Act may increase interest for retirement income portfolio building blocks, in our view.



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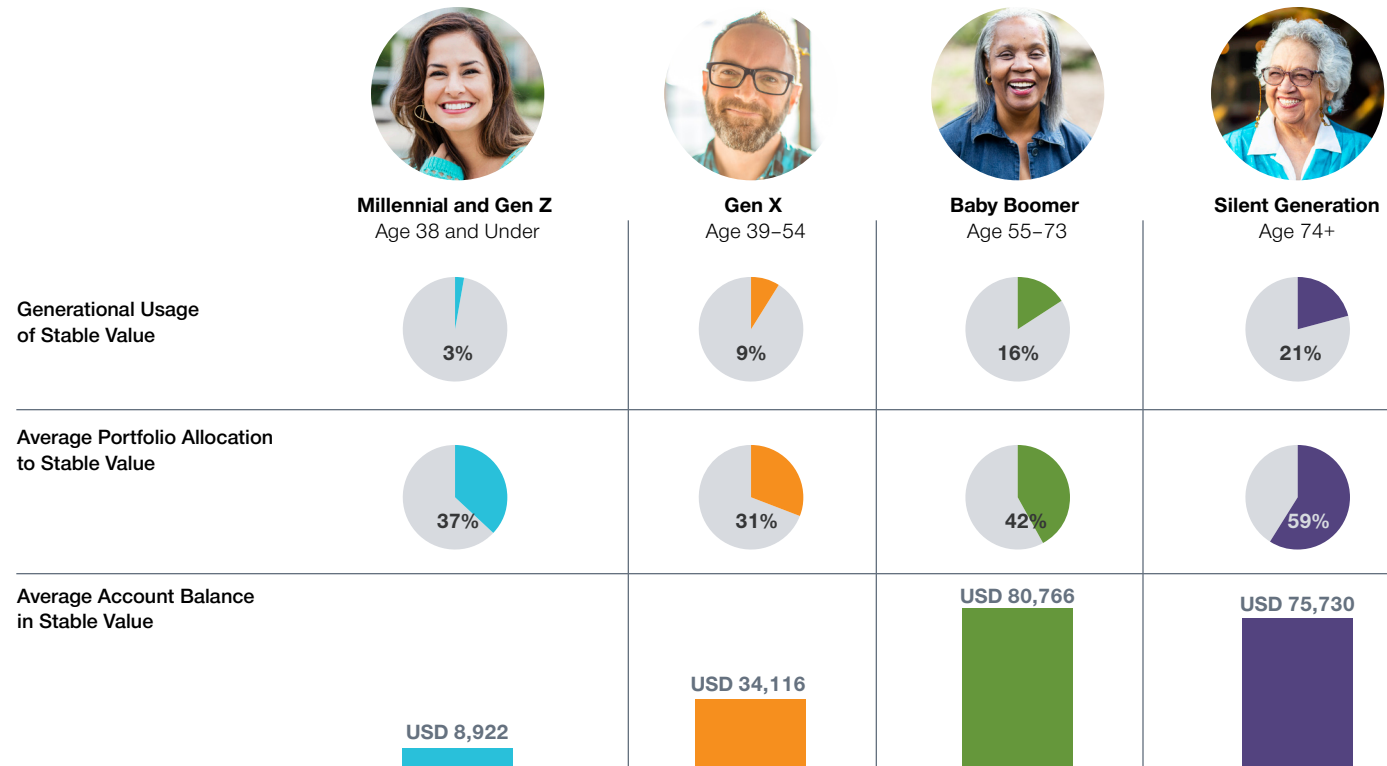
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Generational Use of Stable Value

(Fig. 1) Participants across generations use stable value as expected.



Source: 2019, Based on quarterly data for all DC plan participants in retirement plans administered by T. Rowe Price. T. Rowe Price Retirement Plan Services, Inc.

Skillfully Negotiating Through Market Cycles

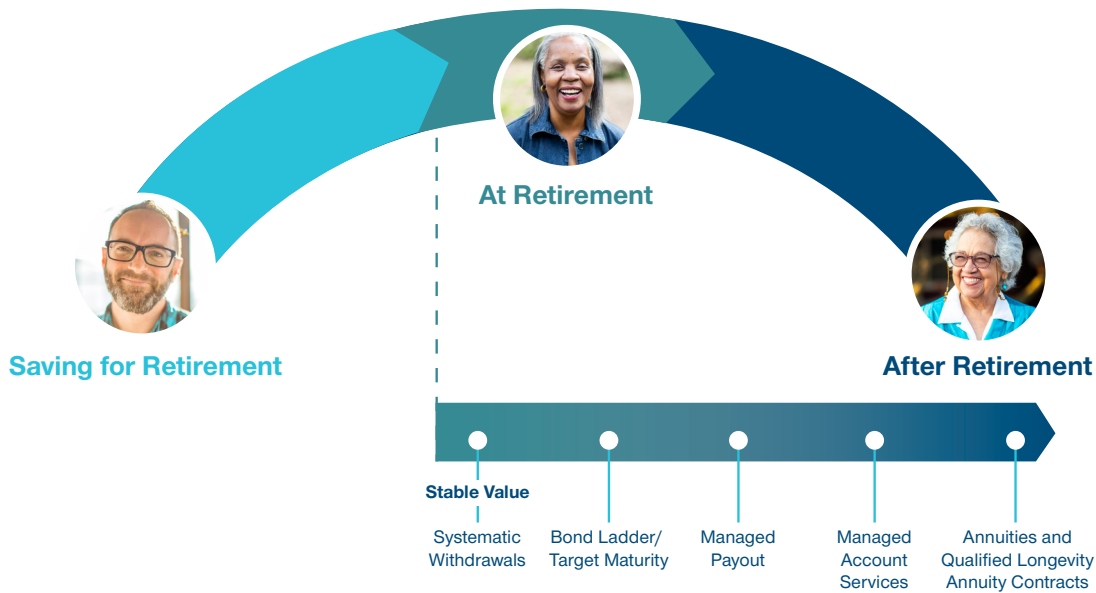
Perhaps the best way to view the adaptability of stable value is to examine the state of the industry before, during, and after the global financial crisis (GFC), a period that represents nearly a full market cycle. Stable value has endured periodic market disruptions, regulatory changes, and vastly different economic conditions. The level of change in the industry is best represented by the swings in negotiating leverage over the past 10 to 15 years (Figure 3). However, we believe stable value's adaptability has been a critical element of its continued growth and appeal.

Before the GFC, investment managers benefited from greater negotiating

leverage with lower wrap fees and ample capacity. Investment guidelines were more relaxed by today's standards and often allowed for the inclusion of securities that would be generally considered inappropriate for stable value investment today, such as subprime and private-label mortgages, high yield, and emerging market debt. Once the crisis unfolded, the pendulum swung in the favor of wrap providers. Wrap fees spiked higher and capacity became limited. Wrap providers also became much more risk averse and demanded more conservative investment guidelines. Wrap providers also used templated or standardized guidelines across investment managers, which did not allow any leeway in tailoring guidelines to an individual manager's strengths.

Stable Value's Adaptability

(Fig. 2) Stable value has a potential role throughout the retirement life cycle.



For illustrative purposes only, not to be considered investment advice.

In this post-GFC period, T. Rowe Price has worked with wrap providers to simplify our stable value strategy and make it more accessible for plan sponsors and participants.

In today's environment, the stable value industry is more balanced. Wrap fees are more competitive, and wrap capacity, having increased as the market rebounded after the GFC, remains ample. Investment guidelines have become less restrictive, though in our view meet the needs of stable value investors. More importantly, wrap providers have moved away from templated investment guidelines and can be customized for each investment manager.

Simplifying Stable Value by Knocking Down Barriers to Entry

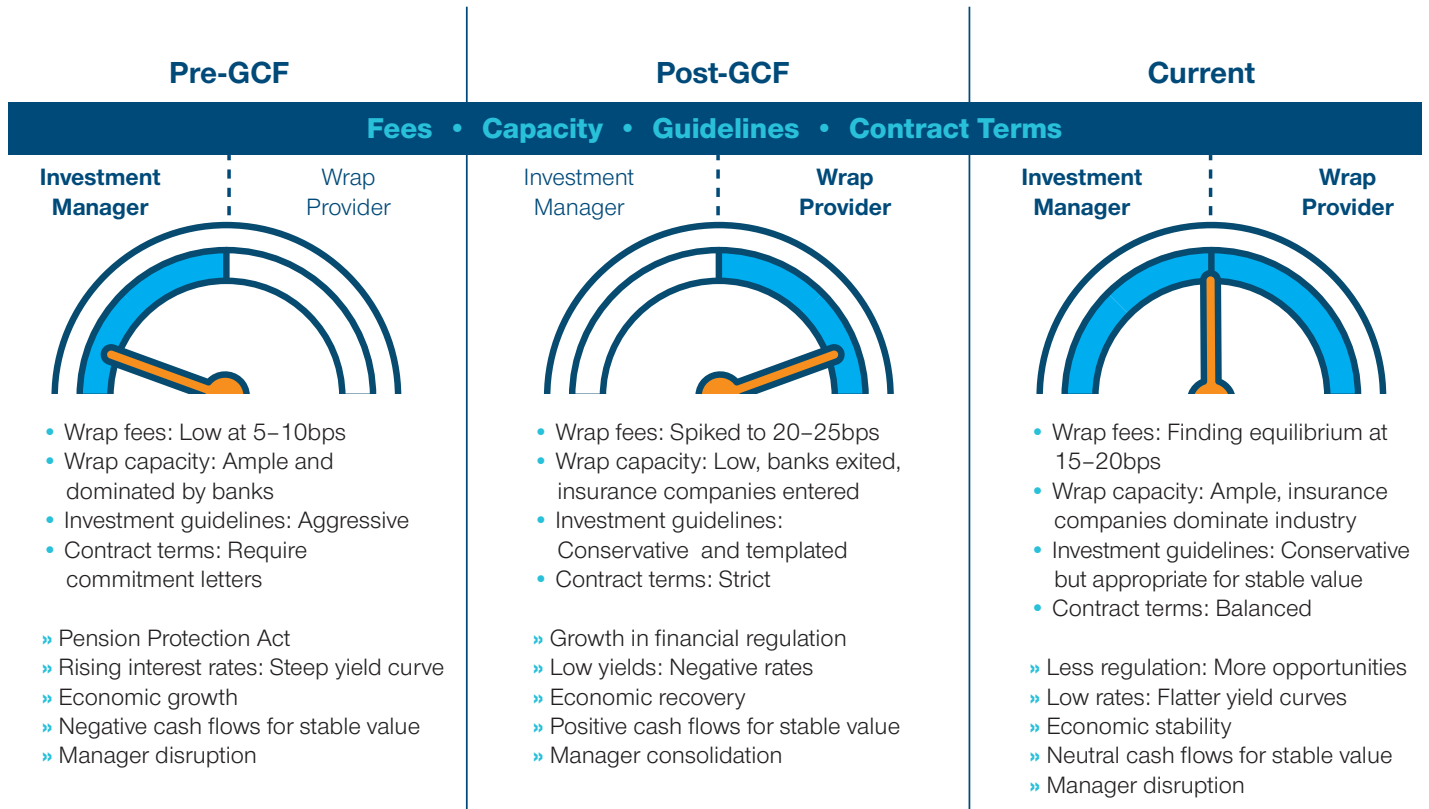
In this post-GFC period, T. Rowe Price has worked with wrap providers to simplify our stable value strategy and make it more accessible for plan sponsors and participants. Our recordkeeping platform includes more than 2 million Retirement Plan Services participants across more than 5,300 plans. Our footprint in the DC space has enabled us to facilitate adjustments between our platform and wrap

providers that we believe are helpful to plan sponsors and participants without adding risk to our wrap providers.

We have worked with wrap issuers to relax some of the rules in the competing fund definition for our stable value portfolios. Wrap providers mandate competing fund provisions to prevent participants from arbitraging between stable value and other similar fixed income strategies by using an equity wash. For the pooled vehicle in our strategy, we were able to make the case for lowering the duration of a competing fund's definition down to two years from three years—to help make stable value more accessible and less onerous for participants and plan sponsors. Importantly, a competing fund, in the pooled vehicle, will also no longer include self-directed brokerage. These changes are being negotiated and implemented on a case-by-case basis for separate accounts currently in our strategy.

The GFC's Impact on Stable Value

(Fig. 3) Negotiating leverage between managers and wrap providers is much more balanced.



Note: bps = basis points.

Increasing Range of Stable Value Usage

Stable value has changed much since its inception (Figure 4). Beyond making stable value look and feel more like other fixed income options, today's stable value solutions are more portable across recordkeeping platforms and more transparent in terms of crediting rates, fees, and holdings. Moreover, as wrap providers become more willing to relax put provisions for non-participant-directed transactions, stable value portfolios can be used as building blocks in other investment strategies like custom target date funds; managed accounts; and, in the future, retirement income strategies. Because of its focus on capital preservation and performance characteristics, stable value is often used as a cash substitute and, in some instances, can replace the entire

fixed income allocation in many asset allocation models.



In addition to making stable value easier to use, we believe stable value managers must continue to work with wrap providers to ensure stable value is keeping pace with other fixed income strategies in terms of investment innovations and capabilities and to include integrating environmental, social, and governance (ESG) investing into their investment processes. At T. Rowe Price, we recognize the importance in ESG among plan sponsors and have begun the process of integrating ESG across our investment strategies.

To augment our stable value platform's flexibility as a solutions provider, T. Rowe Price added a multi-manager capability to our suite of stable value product offerings in early 2019. As

“As we look forward, we believe flexibility is critical as interest in and usage of stable value expands.”

The Evolution of Stable Value

(Fig. 4) The structure and uses of stable value continue to evolve.

| | Historical | Future |
|--|--|---|
| Product Structure and Features  | <ul style="list-style-type: none"> • Guaranteed Investment Contracts • Opaque • Single-Wrap • Proprietary Manager Only | <ul style="list-style-type: none"> • Synthetic Investment Contracts • Transparent (holdings, fees) • Multi-wrap • Multi-manager • Active Fixed Income Management • Flexible Contract Terms (exit provisions, liquidity corridors, competing fund definitions) |
| Use Cases  | <ul style="list-style-type: none"> • Standalone Investment Option • Target Date Funds • Managed Accounts • 529 Plans | <ul style="list-style-type: none"> • Retirement Income • 403(b) Plans • Nonqualified Plans • International Retirement Plans |

For illustrative purposes only. Shows historical and possible future applications.

a multi-manager solutions provider, we sought to improve upon existing product offerings to seek better long-term investment outcomes by leveraging the asset allocation and modeling capabilities that power our industry-leading multi-asset team and target date fund products. Moreover, we have focused on streamlining the investment and compliance processes by improving technology and electronic connectivity between T. Rowe Price and external managers.

Conclusion

As we look forward, we believe flexibility is critical as interest in and usage of stable value expands. Wrap providers and stable value managers need to continue to innovate and look for ways

to simplify stable value offerings while maintaining attractive qualities that are unique to the asset class.

Stable value investing plays a core role as a standalone offering in DC plans. But as the retirement industry evolves, we believe stable value will gain traction as an anchor in the retirement strategies framework. Possible future applications include the use of stable value offerings as building blocks in custom target date strategies or other default strategies; use as a central lever in a suite of retirement income solutions; and, in time, with the passage of the Portman-Cardin reform bill, use in expanded plan types such as 403(b) plans. We remain vigilant in our approach to be nimble, adaptable, and prepared to meet evolving market needs.

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