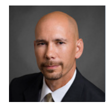
**T. ROWE PRICE INSIGHTS**
ON STABLE VALUE

# How to Evaluate Stable Value Wrap Providers

Research is imperative when considering wrap providers.

June 2021



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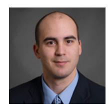

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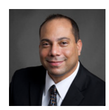

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Often, we are asked our thoughts on the ideal number of wrap providers and the benefits of a multi-wrap solution versus a single-wrap solution. In addition to the ideal number of wrap providers, it is also important that consultants, financial professionals, and plan sponsors understand how a stable value manager approves, evaluates, selects, and monitors wrap providers.

Wrap providers and wrap capacity are vital parts of the success of the stable value industry. A lesson learned following the 2008 global financial crisis (GFC) was that maintaining excess wrap capacity across a broadly diversified approved list of bank and insurance companies would be important in the runup to the next market downturn. Our experience was not unlike our peers, where wrap capacity was restricted and many of our approved wrap providers exited the industry.

Over the next several years following the GFC, we not only diligently replaced those wrap providers who exited the industry, we also expanded our list of approved wrap providers fourfold and built up available excess wrap capacity. In addition, wrap issuers across the industry bolstered their process for evaluating both stable value managers and the portfolios they wrap in order to more fully understand the risks they are undertaking in wrapping stable value portfolios.

Fast-forward to the period of market dislocation following the global spread of the coronavirus in 2020: With the wrap providers on more firm footing and a large number of available wrap contracts, wrap capacity remained ample for our clients. The stability of the wrap provider universe in 2020 was notable given the large amount of inflows into stable value as plan participants sought less-volatile assets.

At T. Rowe Price, we have approved 14 high-quality insurance company and bank wrap providers for use across our stable value platform. More importantly, we bolstered our wrap provider selection and monitoring process to reflect the factors we believe are most important to stable value investors.

### How Does T. Rowe Price Choose Wrap Providers?

We have developed a robust wrap provider evaluation, selection, and monitoring process. Our process is focused on evaluating wrap providers in five key areas—credit quality, contract terms, investment guidelines, fees, and commitment to the business.

## Key Selection Factors and Monitoring Process

Our wrap issuer selection process is as rigorous as our investment process.

**Credit Quality**
**Detailed in-house research** produces proprietary ratings. ***The credit analyst's view is independent of the portfolio manager.***

**Contract Terms**
Each contract is customized for a **client's specific investment objectives**.

**Investment Guidelines**
Investment guidelines are **matched with the client's risk and return profile**.

**Fees**
T. Rowe Price negotiates **fees to be commensurate with risk**.

**Commitment**
An assessment is made on the issuer's commitment to the business and **willingness to change**.

> "...we believe that the credit quality of a wrap contract issuer, which reflects the issuer's financial strength, is the most important factor.

### Credit Research Is the First Step

One of the primary investment objectives of a stable value fund is to maintain principal protection for participants even in challenging market environments. For that reason, we believe that the credit quality of a wrap contract issuer, which reflects the issuer's financial strength, is the most important factor. And, as a result, issuer credit quality is the highest weighted criteria in our multifactor model.

At T. Rowe Price, we leverage our internal credit research team to analyze the financial strength of the wrap providers. Credit research on contract issuers begins with an analysis of key financial data from both annual statutory statements and audited generally accepted accounting principles. These data are then put into an analytical model where the wrap providers are evaluated on a standalone basis and relative to their peers. Our analysts evaluate criteria, including earnings diversification and stability, profitability, and future growth plans to help ensure that the business can generate enough capital to support the company. We then take into account the quality of the investment portfolio and the creditworthiness of each major product line with a series of stress tests in aiming to ensure that the wrap provider holds sufficient levels of capital for a variety of economic environments.

Our credit analyst's view is independent of the stable value portfolio managers. Only after the analyst has approved the wrap provider from a credit standpoint can the stable value team start the process of negotiating contract terms, fees, and investment guidelines.

### Streamlining Contract Terms and Investment Guidelines

While every contract is individually negotiated and different, we have developed a contract template for each wrap issuer. Establishing a contract template requires a significant amount of upfront investment to assure that there is an appropriate transfer of risk to the issuer and that the plan has sufficient contract flexibility to manage the plan and changes thereto. This template process decreases contract variability between providers and is designed to help assure consistency between contracts.

The same holds true as it relates to investment guidelines. We work with our fixed income team and the wrap providers to identify an appropriate amount of flexibility to allow us to potentially add value from a return perspective, consistent with the ultimate capital preservation objective.

> One of the benefits of maintaining strong relationships with 14 wrap issuers is that it provides us with a high degree of transparency into the wrap market with respect to contract terms...

Wrap fees are also an important component as our goal is to negotiate the lowest fees commensurate with the risk taken by the wrap providers. We work closely with the wrap providers to provide the underwriting criteria that they need to price the wrap contract risk while offering them competitive feedback on market pricing to help ensure that our clients are benefiting from some of the most competitive fees.

One of the benefits of maintaining strong relationships with 14 wrap issuers is that it provides us with a high degree of transparency into the wrap market with respect to contract terms, investment guidelines, and fees. Each contract is regularly reviewed and updated to reflect the most current terms, guidelines, and fees with a goal of benefiting our clients.

### Gauging a Provider's Commitment to the Industry

Another important factor in our wrap provider evaluation process is our view of the wrap issuers' commitment to the business. The wrap market dislocation during the GFC highlighted that wrap providers, all the way up to the senior management level, must fully understand the risks they are undertaking in wrapping stable value contracts. One measure of a wrap provider's commitment to the business is how much are they spending on manager surveillance, including portfolio management systems and technology. Prior to the financial crisis, most wrap providers did very modest manager surveillance. In addition, most communication between wrap providers and managers was done over the phone or at industry conferences. Surprisingly, most wrap providers did not regularly visit the managers and investment teams that they underwrote.

Much has changed since the GFC. Most wrap providers have invested heavily in their businesses, in their operations, and in manager surveillance. In some cases, wrap providers have hired external advisors or consultants to participate in the due diligence process. Today, we typically see wrap providers on-site at least once per year, and many bring a team of investment, compliance, and legal professionals to conduct their ongoing due diligence.

In summary, commitment to the business is a good way of assessing whether the wrap provider truly understands stable value risk and, more importantly, whether the wrap provider would be more likely to offer additional capacity in all types of markets.

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ID0004267 (06/2021)
202106-1692189