



Stable Value Guidelines Evolved Over Recent Decades

Wrap contracts need to keep pace with plan sponsor demands.

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Wrap contracts are the lifeblood of any product offering in the stable value investment option. And as stable value becomes more widely available and usage increases among defined contribution (DC) plans, it is incumbent upon wrap providers to keep pace with DC product growth and innovation.

After the 2008 global financial crisis (GFC), the stable value industry witnessed some of the most significant product and wrap contract development and innovation since the advent of synthetic investment contracts more than 30 years ago. In addition, stable value assets grew strongly in the period following the GFC, and the

Wrap Contract Terms Evolution

(Fig. 1) Providers have adapted markedly since the GFC

Contract Terms	Year 2008	Year 2021
Wrap Capacity	13 wrap issuers, five of which were banks, and wrap capacity totaled around USD 360 billion.	16 active issuers, three of which were banks as of June 30, 2021. Wrap capacity has grown to more than USD 480 billion. ¹
Wrap Fees	Average wrap fees spiked to more than 20 basis points from the middle single digits.	Average wrap fees sit between 15 and 17 basis points, determined by the wrap provider and manager.
Book Value Corridor ²	Around 20% lifetime.	15% rolling 12 months, no lifetime limit.
Equity Wash for Competing Funds	Included fixed income funds with duration of three years or fewer, Treasury inflation protected securities (TIPS), self-directed brokerage accounts (SDBA), and money market funds.	Generally fixed income funds with duration of two years or fewer and money market funds. Typically excludes TIPS and SDBA.

Source: Valerian Capital. For Illustrative Purposes Only.

¹ As of June 30, 2021.

² A book value corridor is a provision included in an investment contract that provides a limited amount of book value coverage for certain specified employer-initiated and/or market value events to cover potential losses in market value.



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USD 480b

Wrap capacity has grown to more than USD 480 billion

asset class continued to see significant growth following the broad money market reforms in 2016 and the 2020 coronavirus pandemic.

From our perspective, the post-GFC era, along with regulatory changes from the Dodd-Frank Act, brought welcome updates for both wrap providers and wrap contracts. We would argue that regulatory changes put wrap providers in a stronger financial position in the runup to the 2020 coronavirus crisis. Interestingly enough, wrap capacity expanded during the pandemic and wrap providers remained open to new deposits during the crisis in stark contrast to the 2008 GFC, when wrap providers restricted wrap capacity, and stopped taking deposits and a handful of bank wrap providers exited the wrap industry.

Insurance companies now dominate the wrap industry, with only a few large banks remaining in the wrap business. More importantly, there is ample and growing wrap capacity across a broader group of high-quality insurance companies and bank wrap providers. Wrap fees have retreated significantly since the GFC, from around 25 to 30 basis points immediately following the 2008 crisis to about 15 to 17 basis points currently.¹

Wrap contract terms have also evolved in the post-GFC time period. While some contract changes can be attributed to regulatory changes, we believe many of the changes highlighted in Figure 1 were brought about by market forces and the ability of stable value managers to negotiate greater contract term flexibility. In the immediate aftermath of the GFC,

Investment Guideline Evolution

(Fig. 2) Managers and wrap providers have settled on more conservative parameters

Investment Guideline Term	Pre-GFC	Today
Nondollar-Denominated Obligations	Broadly permitted allocation, hedged or unhedged.	Not permitted.
Derivatives	Broad permissibility with or without netting/collateral agreement.	Specified permissibility with netting/collateral agreement.
Securitized	Higher allocation limits, includes allocation to A and BBB rated assets.	More moderate allocation limits, generally limited to AAA or AA rated assets.
Prohibited Investments	Investment guidelines were broader and permitted investments in riskier assets.	<ul style="list-style-type: none"> • Subprime mortgages • Alt-A mortgages • Private-label mortgages • High yield securities • Emerging market securities
Equity Allocations	Generally not permitted.	Permitted by some wrap providers and limited to index funds.

For Illustrative Purposes Only. The chart reflects investment guideline evolution in general. Actual investment guidelines will vary depending on the arrangement, product, and other factors.

¹ As of June 30, 2021.

wrap providers took a more risk-averse approach and generally offered revised contracts with more conservative investment guidelines.

Today, we are seeing more flexible contract terms regarding equity wash provisions, competing fund definitions, and put provisions as wrap providers become more comfortable in the current market environment. Investment guidelines are also typically more flexible as wrap providers have upgraded their manager selection and risk management systems. Finally, ample wrap capacity and increased competition from new market entrants has been a catalyst for change and increased flexibility in terms of investment guidelines.

Figure 2 highlights key contract changes that have evolved since 2008; however, to be sure, not all contract terms are available across the industry. Investment guidelines have also evolved in the post-2008 GFC time period as managers and wrap providers settled on a more conservative set of investment guidelines.

The 2008 GFC resulted in a number of investment guidelines changes and

exclusions of a number of specific sectors and asset classes, like subprime mortgages, high yield, and emerging markets debt.

Conclusions

As we have seen tremendous asset growth, availability, and increased usage of stable value products since the GFC, we believe it is imperative that the stable value industry ensures wrap contracts keep pace with DC product development and innovation.

Over the past decade, we have also witnessed significant changes to contract terms and investment guidelines that we believe have made stable value easier to use and a more attractive investment for plan sponsors and investment professionals.

In the coming years, stable value products should continue to evolve and innovate as potential markets expand beyond 401(k) plans and likely include multi-asset and retirement income product offerings.

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