What Is Stable Value?

Demystifying and explaining the retirement investment option.

November 2022

KEY INSIGHTS

- Stable value has faced several challenging markets over the years and weathered the economic crisis following the coronavirus pandemic and the recent increased market volatility as global central banks tighten monetary policy.
- The wrap landscape has been resilient and has expanded over the past five years as new wrap providers entered the stable value industry.
- Today, stable value products are offering more flexibility, and their usage has increased and expanded beyond their traditional role in defined contribution retirement plans.

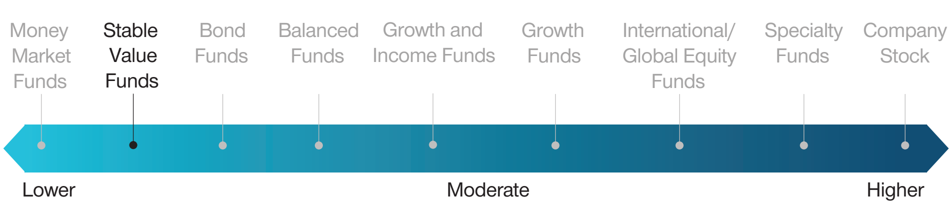
Stable value investment options have been offered in defined contribution plans since the 1970s and have offered a unique combination of benefits for participants. Within an investment lineup, stable value is a lower-risk investment option focused on principal preservation and liquidity while aiming to provide steady positive returns and a stable net asset value.

Investment Risk Spectrum

Stable value is unique in that it is available only in tax-qualified retirement savings plans and in some tuition assistance plans (529 plans).

Investment Risk Spectrum

(Fig. 1) Stable value is at the lower end of the risk spectrum

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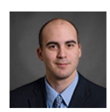
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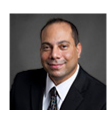
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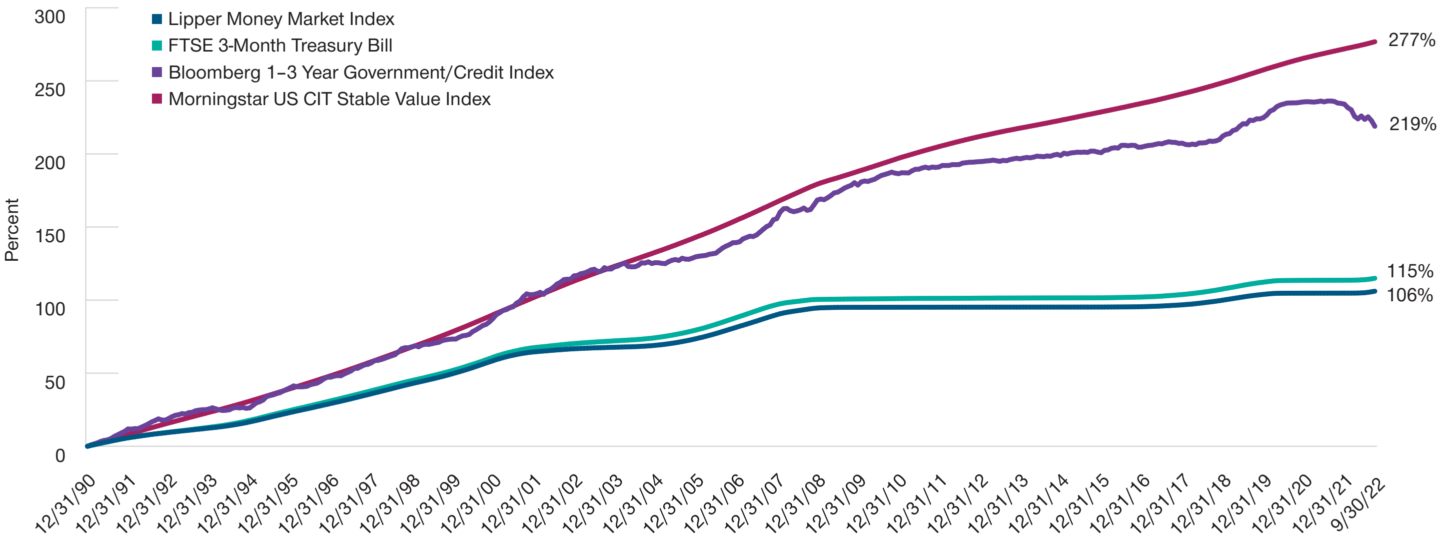
Cumulative Growth Over 30 Years

(Fig. 2) Stable value has held up well over money market funds



As of September 30, 2022.

Past performance is not a reliable indicator of future performance.

Money market funds and stable value products have different risks, including the possible loss of principal. It is important that you carefully review the legal documents for each type of vehicle to determine if it is appropriate for you prior to investment.

Sources: Lipper, FTSE, Bloomberg, and Morningstar. Please see Additional Disclosures for more information.

The Morningstar US CIT Stable Value Index (Universe), formerly the Hueler Analytics Stable Value Pooled Fund Index, is provided by Morningstar, Inc., a financial services firm, and provides an array of investment research and investment management services. The Morningstar US CIT Stable Value Index is an equal-weighted total return average across all participating funds in the Universe and represents approximately 75% of the stable value pooled funds available to the marketplace. Universe rates of return are reported gross of management fees.

Data provided on this page include the historical information of the Hueler Pooled Fund Index through December 31, 2020, and the Morningstar US CIT Stable Value Index from January 3, 2021, to current period ending date.

Stable value, however, is not available in individual retirement accounts or as a mutual fund. Stable value funds are held in nearly half of all defined contribution (DC) plans and represent about 12% of all DC plan assets, and stable value assets totaled over USD 931 billion.[1]

What Is Stable Value Designed to Do?

In general, stable value is a principal preservation investment option that aims to provide a $1 net asset value price for participants and their daily liquidity needs. Relative to money market funds, however, stable value has demonstrated more attractive performance while offering significantly lower volatility than intermediate duration bond funds.

What Are Investment Contracts?

While the portfolio structure and underlying investments within a stable value offering vary, the important similarity in all stable value is the use of investment contracts issued by insurance companies and banks.

Investment contracts are individually negotiated between the issuer and stable value manager and perform many functions. In general, they provide participants daily liquidity and help smooth out short-term volatility over a longer period. Moreover, investment contracts allow for benefit responsiveness, which means that participants can transact at their invested balance plus any accrued interest.

[1] Source: Stable Value Investment Association as of June 30, 2022.

> A stable value portfolio's crediting rate is the yield at which participant account balances accrue interest and is similar to an annual effective yield for a stable value investment contract.

More importantly, investment contracts are ultimately backed by the full financial strength and credit of the bank or insurance company issuer and help guard participants against loss of principal.

As noted above, investment contracts are individually negotiated between the issuer and stable value manager. Currently, there are four main types of investment contracts:

1. **Synthetic investment contracts (SICs)** are issued by an insurance company or a bank and are supported by underlying fixed income assets that are directly owned by the participating plan or trust.
2. **Separate account contracts (SACs)** are similar to SICs, but the underlying fixed income assets are owned by the company issuing the SAC and are held for the benefit of the plan or trust.
3. **A guaranteed investment contract (GIC)** is a stable value investment contract issued by an insurance company and usually pays a specified rate of return for a defined and finite period, guarantees principal and accumulated interest, and is benefit responsive to qualified participant withdrawals.
4. **General account and general account separate account contracts** are exclusively insurance company products that are similar to GICs with the main differences being that a general account contract has no maturity date and rates are reset on a periodic basis.

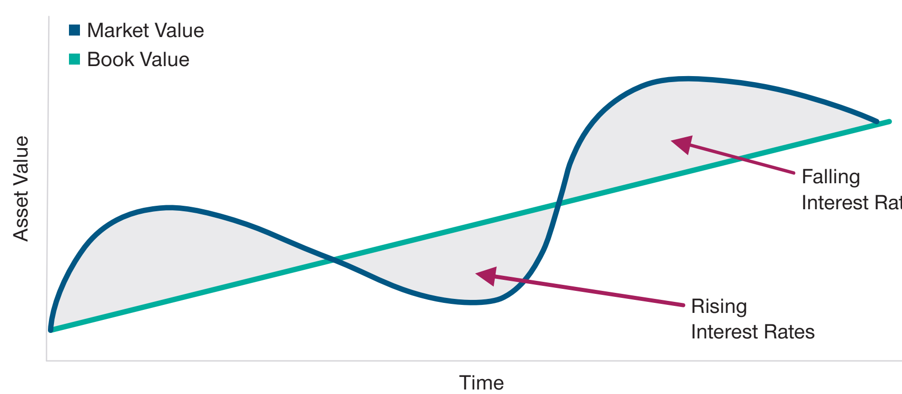
What Is The Stable Value Crediting Rate?

A stable value portfolio's crediting rate is the yield at which participant account balances accrue interest and is similar to an annual effective yield for a stable value investment contract. The crediting rate is set by the stable value manager and/or investment contract issuers based on the characteristics of the underlying investments and is generally reset at the beginning of each quarter (although more frequent rate resets, such as monthly, can also be used, or the crediting rate may be fixed).

The crediting rate is based on a few generally accepted formulas that usually take into consideration the characteristics of the underlying stable value fixed income investment; e.g., portfolio yield, duration, etc.

How Do M/B Ratios Behave?

(Fig. 3) M/B ratios are negatively correlated with rates



The example provided is hypothetical and used for illustrative purposes only.

In conclusion, stable value has been a mainstay in retirement plans since its adoption in the 1970s.

What Is the Market-to-Book Value Ratio?

Stable value portfolios are valued both on an investment contract or book value basis as well as on a market value basis for the underlying fixed income investments. Book value and market value are expressed as:

Market Value = The fair market value of the underlying fixed income investments

Book Value = Initial principal + accumulated interest + additional deposits - withdrawals - expenses

The market-to-book value ratio (M/B ratio) is a stable value portfolio's market value divided by its book value. The M/B ratio is an indication of the fair market value of the underlying assets relative to the book value of the underlying assets of the investment contract. Figure 3 shows how the value of the investment contracts changes as the market value and book value of the underlying assets change over time and over various interest rate environments. M/B ratios are expected to fluctuate within a band around 100% during periods of rising and falling rates as bond prices are negatively correlated to changes in interest rates.

Stable Value Portfolio Structure

A typical stable value portfolio is composed of investment contracts (e.g., SICs, SACs, GICs), a cash buffer, and underlying fixed income investments. In most cases, the underlying fixed income investments are arrayed in one or more high-quality fixed income strategies, which are often benchmarked against commonly available indexes. The cash buffer falls outside the investment contracts and is typically invested in a stable net asset value product like a U.S. government or U.S. Treasury money market fund.

Cash buffers are an important component of stable value and are there to provide daily liquidity for participants handling all daily deposits and withdrawals, while the remaining assets in the stable value portfolio remain fully invested. However, general account contracts are an exception as they don't typically require a cash buffer.

The overall duration of the stable value portfolio will vary depending on the stable value manager and the needs of the plan sponsor but could generally range from one to six years.

Conclusion

In conclusion, stable value has been a mainstay in retirement plans since its adoption in the 1970s. Today, stable value continues to be an attractive and popular investment option for participants seeking principal preservation, income, and competitive yields with lower correlation to other asset classes.

Given its unique features and competitive performance, stable value is a popular option in retirement and is increasingly being used in 529 plans, asset allocation products like target date funds, and retirement income products in a variety of new solutions. We believe this trend will continue as stable value products continue to receive increased awareness and usage and expand beyond their traditional role as a safe harbor investment option.

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