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How to Evaluate Stable Value Funds

Speakers during a Broadridge webinar discussed steps to evaluate the instruments, as well as what elements plan sponsors should consider.

When performing due diligence during the selection of stable value funds, it is important to cover four main areas, said Matt Curtin, sales director, MetLife Stable Value Investments, during a Broadridge webinar, "Enhancing Your Stable Value Product Due Diligence."

Plan sponsors should consider performance, historical gross crediting rates versus a peer median, historical market to book ratios versus a peer median, and expenses (share class versus a peer median), he said.

When it comes to performance, it is customary to look at three-month, year-to-date, one-year, three-year, five-year and 10-year performances, Curtin said.

He said expenses include the investment management, or trustee, fee, and the expenses of the wrap provider(s). "Not all funds are constructed the same," he said. "Therefore, expenses will be disparate. Expenses are an important aspect of review, but simply one component."

Beyond that, it is important to look under the hood at the fund's investments and the credit quality of the fund versus its peer median, Curtin said. "Why are crediting rates so important for stable value funds? They create the end result of what is actually being provided to the participant," he explained. "They smooth out market volatility."

He said sponsors should also ask if the fund is properly diversified among sectors, and how this compares to its peer median. Then it is critical to look at the credit quality of the portfolio issuers and wrap providers.

"Obtain a clear understanding of the contract/product features and terms, including full disclosures of the fund, including fees and expenses," Curtin said. "Understand participant transfer and withdrawal restrictions. Conduct a complete review of the wrap or guarantor structure, including: the creditworthiness of the wrap providers or guarantor; contract termination provisions and portability options; and if there is a guaranteed minimum interest rate."

Curtin continued: "Evaluate the underlying investment structure, including portfolio composition and quality; historical market-to-book value ratio; and crediting rate history. Establish a fiduciary oversight policy including ongoing performance evaluation; monitoring creditworthiness of the wrap issuers or guarantor; and develop a list of key due diligence questions."

Curtin said he is seeing some trends in the stable value marketplace. "We anticipate the credit rate of stable value funds will decrease nominally until rates track back up again," he said. "It is a very positive market environment for stable value right now, with interest rates remaining low."

David Berg, executive vice president at PIMCO, said stable value selection doesn't need to be an overly complex process.

"Perform an analysis to determine what type of stable value vehicle is best for your plan, looking at its transparency, exit provisions and credit exposure," he said. "Then ask questions relevant to each type of stable value product, and look at the breadth and depth of the experience of its managers. Then gather data. Fi360 can help."

Michael Muirhead, senior director, learning and development for Fi360, a Broadridge company, said decisions regarding investment strategies and types of investments should be made in accordance with fiduciary obligations and be well documented.

He said Broadridge recommends: "A prudent due diligence process to select investment strategies, investment managers and investments. Decisions regarding the selection of investments should consider both qualitative and quantitative criteria. The due diligence process used to select investment strategies, investment managers and investments must be documented and consistently applied."

He added that the firm prefers regulated investments over unregulated investments when all other characteristics are comparable. "We also prefer investments that are covered by readily available data sources over similar investments for which limited coverage is available when all other characteristics are comparable," he said. "Finally, we recommend that a prudent due diligence process is used when deciding whether to use proprietary versus nonproprietary products and separately managed accounts versus commingled accounts."

In closing, Curtin said, stable value continues to be an important asset class for retirement plans. As of last December, there was $902 billion invested in stable value.

"A well-diversified defined contribution [DC] plan should include a preservation option," he said. "Advisers are engaging their plan sponsor clients on the benefits of stable value and the better outcomes they provide in this low interest rate environment, compared to money market funds. Nine-point-one percent of 401(k) plan assets are invested in stable value funds—and this is true from startups to Fortune 100 companies. Sixty-nine percent of large 401(k) plans offer stable value. These funds have proven to be resilient, consistent and predictable, regardless of market conditions. Since their inception, stable value funds have responded to and weathered 20 significant interest rate changes. Perhaps most notably, in 2020, 39% of 401(k) inflows went to stable value." ●