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Why Plan Sponsors Should Choose Stable Value Rather Than Money Market Funds

Tom Schuster, vice president and head of MetLife's Stable Value Investment Products, explains why stable value is an increasingly attractive option for plan sponsors and participants, particularly compared to money market funds.

P&I: Why should plan sponsors and consultants choose stable value over other capital preservation options, particularly over money market funds (MMFs), in their DC plans?

Tom Schuster: First and foremost, stable value should be considered based upon the significant return premium that it has historically delivered over MMFs. It's important to remember that to the end consumers, stable value's higher returns over time are extremely meaningful to their ability to accumulate retirement assets.

Stable value was financially engineered specifically for the defined contribution market and is only available in DC plans. Money market funds are designed to provide daily liquidity outside DC plans. DC plan participants who select money market funds are sacrificing additional returns in exchange for retail liquidity they do not need. Stable value offers participants a product with a stable net asset value, with returns far in excess of money market funds and with lower risk. Participants can transact at book value as often as they are allowed by the plan.

P&I: What is the historical performance of stable value funds compared to MMFs, including a fundamental risk return analysis?

Tom Schuster: Based on a recent MetLife analysis of stable value, stable value annualized returns outperformed MMFs by more than 200 basis points over a 10-year period ending June 30, 2015. MMFs did not outperform stable value for a single quarter during this 10-year period. The volatility of returns was also significantly lower for stable value than for MMFs.

On a real return basis, which takes into account inflation over this time frame, money market eroded purchasing power at an annualized rate of 75 basis points, while stable value enhanced purchasing power.

Here is an illustration that captures the importance of the stable value return premium. We compared the growth of $100 invested in stable value and money market for the 10-year period. During that period, the $100 would have grown to $140 invested in stable value, but only to $114 in a money market. Stable value delivered these significantly higher returns than money market with less volatility.

P&I: What about some of the regulatory considerations for sponsors? In particular, what are the practical implications of the recent money market reforms?

Tom Schuster: Two rounds of money market reform by the U.S. Securities and Exchange Commission have reduced the expected returns for MMFs and made them less customer friendly, a reason plan sponsors should be reassessing offering money market.

There will be an impact on liquidity and fees for MMFs. One possible outcome is some MMFs may even enforce claw-back provisions that allow them to recover fees that had previously been waived.

P&I: What about other legal risk regarding MMFs in light of recent litigation (i.e., Abbott v. Lockheed Martin and Tibble v. Edison)?

Tom Schuster: In Tibble v. Edison, the Supreme Court unanimously decided that plan fiduciaries have a continuing duty to evaluate the prudence of retaining a plan investment option.

It's clear that the long period of zero nominal returns, negative real returns and regulatory changes will further decrease the value of MMFs to participants and will require that plan sponsors re-evaluate the use of money market among their plan options.

The class action of Abbott v. Lockheed Martin shows the economic dangers plan sponsors with money market may face. The case was recently settled for $62 million. Some $29 million of the settlement was allocated to the claim of too high an allocation to money market instruments. In my opinion, plan sponsors with money market face enhanced litigation risks that may result in significant damage awards.

P&I: When switching from money market to stable value, what are some of the key considerations plan sponsors and their advisers should contemplate when selecting a stable value fund?

Tom Schuster: One key consideration to evaluate is the diversification of risk.

While diversification by stable value contract provider is prudent, plan sponsors should likewise evaluate diversification by asset manager and manager style within the stable value option as well as diversification by stable value contract type.

Diversification by asset manager style and contract structure are often overlooked and may have a greater impact on plan participants than diversification by provider.

P&I: What are next steps in educating plan sponsors, participants, consultants and advisers about the advantages of stable value funds?

Tom Schuster: Education is a key element when it comes to stable value. MetLife's own Stable Value Study showed some incremental improvement (e.g., 12% of sponsors who offer stable value added it in the past two years), but showed even more clearly that much more work needs to be done. For example, almost half of the plan sponsors surveyed are unaware that stable value outperformed money market, and only 17% of plan sponsors realize that stable value returns exceeded inflation over the last 25 years.

MetLife is an industry leader in stable value. At MetLife we believe informed plan sponsors, advisers, consultants and participants are important for both stable value business growth and to ensure that plan participants are aware of the benefits that stable value adds as a component of their investment portfolio. ❖

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