

FOR INSTITUTIONAL INVESTORS ONLY. NOT TO BE DISTRIBUTED TO RETAIL CLIENTS. This strategy is offered by Insight North America LLC (INA) in the United States. INA is part of Insight Investment. Performance presented is that of Insight Investment and should not specifically be viewed as the performance of INA. Please refer to the important disclosures at the back of this document.



# EVALUATING A STABLE VALUE INVESTMENT OPTION

CHOOSING AN APPROPRIATE INVESTMENT VEHICLE

SEPTEMBER 2021

# EXECUTIVE SUMMARY

## AN INTRODUCTION TO STABLE VALUE

Stable value investments are a popular investment product offered within participant-directed defined contribution plans (such as 401Ks) and other tax-differed pension savings vehicles. The primary objective of stable value products is capital preservation, with yield or total return a secondary priority. These products provide next day liquidity for participant-directed transactions. However, unlike money market funds, the book valuation of stable value funds is explicitly backed by investment contracts issued through financial institutions. The ability to invest in longer-dated, higher-yielding assets also provides stable value funds with a potential return advantage compared to money market funds. These unique features of stable value products allow investors to target potential returns similar to those of intermediate bond funds with liquidity comparable to money market funds.

TARGETING THE OPTIMAL BALANCE BETWEEN VEHICLE AND STRATEGY // 3

COMMON VEHICLE STRUCTURES // 4

THREE KEY CONSIDERATIONS WHEN CHOOSING A VEHICLE // 4

A QUICK GUIDE TO THE ADVANTAGES AND DISADVANTAGES OF EACH VEHICLE // 6

THE BOTTOM LINE // 6

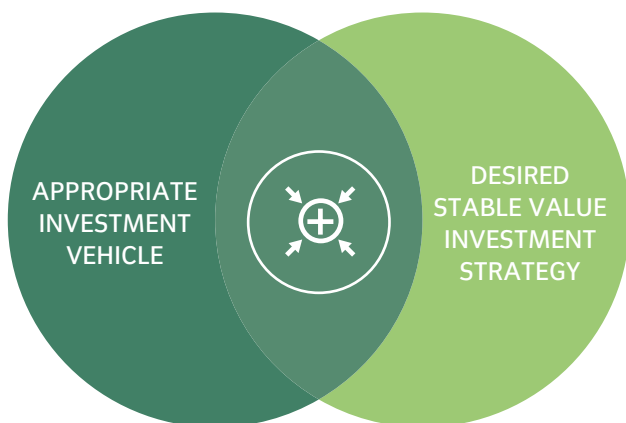
# TARGETING THE OPTIMAL BALANCE BETWEEN VEHICLE AND STRATEGY

PROPERLY EVALUATING STABLE VALUE INVESTMENT OPTIONS IS AN ONGOING CONCERN FOR DEFINED CONTRIBUTION PLAN SPONSORS. STABLE VALUE PRODUCTS CAN DIFFER MATERIALLY IN THEIR VEHICLE STRUCTURES, TERMINATION PROVISIONS, PORTFOLIO COMPOSITION, RISK/RETURN OBJECTIVE, FEES, AND ADMINISTRATIVE COMPLEXITY, MAKING APPLES-TO-APPLES COMPARISONS DIFFICULT.

We believe that a two-pronged approach can remove some of the difficulties of making a direct comparison. In our view, the optimal solution lies in the intersection between the preferred vehicle structure and the investment strategy that aligns with a plan sponsor's risk/return expectations.

## Part 1: Choosing an appropriate investment vehicle

In this first paper, we take a look at structural factors that we believe a plan sponsor should consider when selecting the appropriate stable value investment vehicle.



## Part 2: Choosing an appropriate investment strategy

In the second installment, we explore the investment strategy within the vehicle and dissect the important factors investors should consider.

## COMMON VEHICLE STRUCTURES

There are four common stable value account structures that allow most plan sponsors to align their preferences with the optimal stable value product. Some defined contribution plans, such as 401(k) and 457 plans have the option to use any of the four basic products listed below. Product selection for other plans is more limited, however. For instance, 403(b) plans are currently prohibited from using pooled funds (bank collective trusts) so they must offer either mutual funds or insurance products as their investment vehicle.

### Common vehicle structures

		401(k)	457	403(b)	
1	Insurance Company General Account	An insurance product issued by a single insurance company. The obligation is unsecured and backed by the general account assets of the insurance company.	✓	✓	✓
2	Insurance Company Separate Account	An insurance product issued by a single insurance company that typically manages the underlying assets. The assets are held in a separate account, away from the general account assets of the insurance company.	✓	✓	✓
3	Pooled Fund (bank collective trust)	A diversified portfolio of stable value investment contracts that is designed for plan sponsors who do not have sufficient assets to justify a dedicated separate account.	✓	✓	
4	Dedicated Separate Account	A dedicated account of stable value assets that is managed for a single plan sponsor. Separate accounts typically require \$50 million in assets.	✓	✓	✓

## THREE KEY CONSIDERATIONS WHEN CHOOSING A VEHICLE

### 1 Exit provisions

A valuable feature of stable value investment products is their stability over time – and this includes the ability to complete transactions at book value<sup>1</sup> (under normal circumstances) without concerns about price volatility. However, this stability comes at the cost of liquidity, and plan sponsors need to be acutely aware of the investment vehicle's provisions on withdrawals:

- Insurance company general and separate accounts may have a variety of termination provisions, including a series of payments over time, the lesser of book or market value payout, or a wind-down period over the duration of the account. Some insurance company products have extended book value payout provisions of three-to-five years (or more) if the level of market interest rates is higher than the book value crediting rate of the product.
- Pooled funds generally require 12 months advance notice for a book value termination – known as a 12-month put provision. Some pooled fund managers have increased the 12-month put notification period to 24 months.
- With dedicated separate accounts, terminations must be addressed directly by plan sponsors working with their stable value manager. Usually this is engineered through a wind-down of portfolio duration over a predetermined period of time. At the terminating point in time, the book value will match the underlying market value of the assets in the portfolio.

<sup>1</sup> Book value is principal plus accrued interest of the underlying securities. Market value is the value of the portfolio based on the current prices of the portfolio holdings.

A roach motel is easy to enter but impossible to exit. Unfortunately, many stable value products resemble such a device. They make entering easy but heavily restrict plan sponsor-initiated terminations. Many fiduciaries inherit products with difficult termination provisions through either acquisition or possibly poor decision making by prior associates. Although the most restrictive products have been less prevalent recently, **plan sponsors must be absolutely clear about the termination clauses of any stable value vehicle.** Simply stated, plan sponsors should seek as much flexibility as possible with termination provisions prior to entering a vehicle.

## 2 Fees/expense ratio

At the risk of stating the obvious: less is more. Lower fees provide greater returns for plan participants over time, all else being equal. Active strategies will generally have a higher embedded expense structure, though with the potential for greater return. Passive strategies will generally offer a lower expense structure.

Asset size also determines expenses. Smaller accounts that do not have the scale to justify a dedicated separate account (we believe a minimum size of \$50 million) will be forced to consider higher-cost solutions such as a pooled fund or an insurance company separate account. Larger allocations can use their scale to negotiate lower fees, particularly in a dedicated separate account.

The total expense ratio of a stable value investment vehicle should include trustee/manager fees, synthetic wrap fees and underlying product/subadvisor fees. When comparing the expense ratios of two stable value investment alternatives, it is important to make sure similar categories of fees are included in the analysis.

Once the expense ratios are on a common footing it becomes an easier exercise. With many very capable stable value managers in this asset class, fees can be a significant differentiator

## 3 Complexity/Administrative Requirements

With a larger size stable value allocation, a plan sponsor can realize the many benefits of a dedicated separate account. These may include customized investment guidelines, a lower expense ratio than other investment vehicles, and potentially higher returns. Maintaining a dedicated separate account, however, involves some administrative work. Larger plan sponsors will have the staff to sufficiently address these needs while smaller plan sponsors may be challenged.

Along with annual reporting and audit requirements, a dedicated separate account also requires the negotiation and execution of an investment management agreement and custom investment guidelines. Proper fiduciary oversight structure must be created and maintained. A stable value manager can be counted on to bear much of this work and can minimize some of the administrative burden.

Examples of separate account administrative requirements:

- Investment management agreement and investment guidelines
- Establish and maintain sufficient fiduciary oversight
- Trust and custody arrangement for separate account assets
- Form 5500 tax reporting
- Annual audit





Plan sponsors should seek to match their investment objectives and administrative capabilities with the potential vehicles, mindful of liquidity features and expenses.



## A QUICK GUIDE TO THE ADVANTAGES AND DISADVANTAGES OF EACH VEHICLE

In our view, there are potentially distinct advantages and disadvantages in each of the four basic investment vehicles in the stable value asset class:

	Typical Advantages	Typical Disadvantages
<b>Insurance Company General Account</b>	<ul style="list-style-type: none"><li>• May offer higher yields</li><li>• Low administrative burden</li></ul>	<ul style="list-style-type: none"><li>• No credit diversification</li><li>• Crediting rate calculation and embedded fees are not transparent</li><li>• Plan sponsor termination provisions can be onerous</li></ul>
<b>Insurance Company Separate Account</b>	<ul style="list-style-type: none"><li>• Typically higher yielding</li><li>• Low administrative burden</li></ul>	<ul style="list-style-type: none"><li>• Lack of provider diversification</li><li>• Assets are frequently lower credit quality</li><li>• Plan sponsor termination provisions can be onerous</li></ul>
<b>Pooled Fund (Bank Collective Trust)</b>	<ul style="list-style-type: none"><li>• Diversified portfolio</li><li>• High credit quality</li></ul>	<ul style="list-style-type: none"><li>• Yields can be lower</li><li>• Performance may be influenced by investment activity of other fund holders</li><li>• Plan sponsor termination requires 12-month put notification</li></ul>
<b>Dedicated Separate Account</b>	<ul style="list-style-type: none"><li>• Diversified portfolio</li><li>• Customized investment guidelines</li><li>• Lower fees</li><li>• Performance not influenced by other investors</li></ul>	<ul style="list-style-type: none"><li>• Generally requires minimum asset level (&gt; \$50 million)</li><li>• High administrative burden</li></ul>

## THE BOTTOM LINE

Plan sponsors should seek to match their investment objectives and administrative capabilities with the potential vehicles, mindful of liquidity features and expenses. Once the type of investment vehicle is selected, a plan sponsor can focus on the underlying investment strategy. This topic will be explored in the second part of our series: Choosing an appropriate investment strategy.



## FIND OUT MORE

### Insight Investment

200 Park Avenue, 7th Floor  
New York, NY 10166  
212-527-1800

### Client Relationship Management

institutionalna@insightinvestment.com

### Consultant Relationship Management

consultantsna@insightinvestment.com



@InsightInvestUS



company/insight-investment-north-america



www.insightinvestment.com

## IMPORTANT DISCLOSURES

This document has been prepared by Insight North America LLC (INA), a registered investment adviser under the Investment Advisers Act of 1940 and regulated by the US Securities and Exchange Commission. INA is part of 'Insight' or 'Insight Investment', the corporate brand for certain asset management companies operated by Insight Investment Management Limited including, among others, Insight Investment Management (Global) Limited, Insight Investment International Limited and Insight Investment Management (Europe) Limited (IIMEL).

Opinions expressed herein are current opinions of Insight, and are subject to change without notice. Insight assumes no responsibility to update such information or to notify a client of any changes. Any outlooks, forecasts or portfolio weightings presented herein are as of the date appearing on this material only and are also subject to change without notice. Insight disclaims any responsibility to update such views. No forecasts can be guaranteed.

Nothing in this document is intended to constitute an offer or solicitation to sell or a solicitation of an offer to buy any product or service (nor shall any product or service be offered or sold to any person) in any jurisdiction in which either (a) INA is not licensed to conduct business, and/or (b) an offer, solicitation, purchase or sale would be unavailable or unlawful.

This document should not be duplicated, amended, or forwarded to a third party without consent from INA. This is a marketing document intended for institutional investors only and should not be made available to or relied upon by retail investors. This material is provided for general information only and should not be construed as investment advice or a recommendation. You should consult with your adviser to determine whether any particular investment strategy is appropriate.

Assets under management (AUM) represented by the value of the client's assets or liabilities Insight is asked to manage. These will primarily be the mark-to-market value of securities managed on behalf of clients, including collateral if applicable. Where a client mandate requires Insight to manage some or all of a client's liabilities (e.g. LDI strategies), AUM will be equal to the value of the client specific liability benchmark and/or the notional value of other risk exposure through the use of derivatives. Regulatory assets under management without exposures can be provided upon request. Unless otherwise specified, the performance shown herein is that of Insight Investment (for Global Investment Performance Standards (GIPS), the 'firm') and not specifically of Insight North America. A copy of the GIPS composite disclosure page is available upon request.

Past performance is not a guide to future performance, which will vary. The value of investments and any income from them will fluctuate and is not guaranteed (this may partly be due to exchange rate changes). Future returns are not guaranteed and a loss of principal may occur.

Targeted returns intend to demonstrate that the strategy is managed in such a manner as to seek to achieve the target return over a normal market cycle based on what Insight has observed in the market, generally, over the course of an investment cycle. In no circumstances should the targeted returns be regarded as a representation, warranty or prediction that the specific deal will reflect any particular performance or that it will achieve or is likely to achieve any particular result or that investors will be able to avoid losses, including total losses of their investment.

The information shown is derived from a representative account deemed to appropriately represent the management styles herein. Each investor's portfolio is individually managed and may vary from the information shown. The mention of a specific security is not a recommendation to buy or sell such security. The specific securities identified are not representative of all the securities purchased, sold or recommended for advisory clients. It should not be assumed that an investment in the securities identified will be profitable. Actual holdings will vary for each client and there is no guarantee that a particular client's account will hold any or all of the securities listed.

The quoted benchmarks within this document do not reflect deductions for fees, expenses or taxes. These benchmarks are unmanaged and cannot be purchased directly by investors. Benchmark performance is shown for illustrative purposes only and does not predict or depict the performance of any investment. There may be material factors relevant to any such comparison such as differences in volatility, and regulatory and legal restrictions between the indices shown and the strategy.

Transactions in foreign securities may be executed and settled in local markets. Performance comparisons will be affected by changes in interest rates. Investment returns fluctuate due to changes in market conditions. Investment involves risk, including the possible loss of principal. No assurance can be given that the performance objectives of a given strategy will be achieved.



Insight does not provide tax or legal advice to its clients and all investors are strongly urged to consult their tax and legal advisors regarding any potential strategy or investment.

Information herein may contain, include or is based upon forward-looking statements within the meaning of the federal securities laws, specifically Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements include all statements, other than statements of historical fact, that address future activities, events or developments, including without limitation, business or investment strategy or measures to implement strategy, competitive strengths, goals expansion and growth of our business, plans, prospects and references to future or success. You can identify these statements by the fact that they do not relate strictly to historical or current facts. Words such as 'anticipate', 'estimate', 'expect', 'project', 'intend', 'plan', 'believe', and other similar words are intended to identify these forward-looking statements. Forward-looking statements can be affected by inaccurate assumptions or by known or unknown risks and uncertainties. Many such factors will be important in determining our actual future results or outcomes. Consequently, no forward-looking statement can be guaranteed. Our actual results or outcomes may vary materially. Given these uncertainties, you should not place undue reliance on these forward-looking statements.

Insight and BNY Mellon Securities Corporation are subsidiaries of BNY Mellon. BNYMSC is a registered broker and FINRA member. BNY Mellon is the corporate brand of the Bank of New York Mellon Corporation and may also be used as a generic term to reference the Corporation as a whole or its various subsidiaries generally. Products and services may be provided under various brand names and in various countries by subsidiaries, affiliates and joint ventures of the Bank of New York Mellon Corporation where authorized and regulated as required within each jurisdiction. Unless you are notified to the contrary, the products and services mentioned are not insured by the FDIC (or by any government entity) and are not guaranteed by or obligations of the Bank of New York Mellon Corporation or any of its affiliates. The Bank of New York Mellon Corporation assumes no responsibility for the accuracy or completeness of the above data and disclaims all expressed or implied warranties in connection there with. Personnel of certain of our BNY Mellon affiliates may act as: (i) registered representatives of BNY Mellon Securities Corporation (in its capacity as a registered broker-dealer) to offer securities, (ii) officers of the Bank of New York Mellon (a New York chartered bank) to offer bank-maintained collective investment funds and (iii) associated persons of BNY Mellon Securities Corporation (in its capacity as a registered investment adviser) to offer separately managed accounts managed by BNY Mellon Investment Management firms.

Disclaimer for Non-US Clients: Prospective clients should inform themselves as to the legal requirements and tax consequences within the countries of their citizenship, residence, domicile and place of business with respect to the purchase and ongoing provision of advisory services. No regulator or government authority has reviewed this document or the merits of the products and services referenced herein.

This document is directed and intended for 'institutional investors' (as such term is defined in various jurisdictions). By accepting this document, you agree (a) to keep all information contained herein (the 'Information') confidential, (b) not use the Information for any purpose other than to evaluate a potential investment in any product described herein, and (c) not to distribute the Information to any person other than persons within your organization or to your client that has engaged you to evaluate an investment in such product.

Telephone conversations may be recorded in accordance with applicable laws.

© 2021 Insight Investment. All rights reserved.

