



Stable Value/Tough Choice?

Plan sponsors have an important decision to make--which "cash" vehicle should the plan offer to participants? It would seem to be an easy decision. There are relatively few choices: stable value fund or a money market fund. Such an easy decision ... seems like a no brainer. Hands down, stable value would be the winner. The returns on average are 2% higher annually than money market funds, and stable value pays out at book value, similar to money market funds.

Again, why would anyone choose something different? It seems to be a slam dunk. And yet, plan sponsors are choosing money market funds over stable value funds.

Why? Plan sponsors may have some valid concerns and questions, but simply throwing stable value funds overboard is unwise and might not be prudent.

Several studies have shown that participants select the stable value option disproportionately more than most other investment options. Remember, one of the goals of offering a retirement plan is to attract and retain valuable employees. Therefore, if employees in general select stable value options in disproportionate numbers, then it behooves employers to offer stable value programs. In essence, it is what the customer demands.

Let's walk through a cash allocation decision and the thinking behind why some plan sponsors have chosen money market funds. While many of the concerns are valid, it is



important to separate fact from fiction. Upon closer examination we'll see that stable value remains a strong and even better option for many participants.

Concerns

When I talk with plan sponsors, most of their concerns center around the following: tightened investment guidelines resulting in reduced yields, lack of wrap capacity, increasing wrap fees, and the disclosure of underlying investments.

It is correct that stable value funds have tightened investment guidelines thereby lowering their yields. However, money market funds have adopted similar restrictions. Both investments might yield less in the future, but the spread should remain the same. One can argue that the recent scrutiny and new guidelines have made stable value programs stronger and more transparent. In other words, the lower returns are offset by a stronger and more transparent investment option. This should provide greater comfort to plan sponsors.

Another criticism is that wrap fees have gotten more expensive thereby bringing down the yield of stable value funds. This statement is also correct. Many wrap providers were caught off guard by the recent financial crisis and wrap fees have increased from, on average, 8 basis point to about 20 basis points. However, the increase in fees has attracted stronger players to this market – players who understand the risks related to offering a wrap. Giving up a little bit of yield in exchange for stronger players entering the market is a good risk/reward trade-off. And, as more players enter the wrap market, capacity should grow, and eventually fees may retreat a bit as well.

Lastly and probably the biggest concern relates to the disclosures made to plan participants. Plan sponsors are concerned that participants do not really understand the mechanics of stable value programs. They do not understand the distinction between book value and market value, and generally, it is not always explained that stable value programs are “wrapped” to maintain book value accounting. Furthermore, wrap contracts often prevent plan sponsors from communicating to participants when the market value of the portfolio falls below the book value.

Solution

Yes, no one will argue with the fact that stable value programs are complicated to structure and administer. But, these complications and disclosure challenges should not prompt plan sponsors to take the easy way out by eliminating stable value



programs. Sure, it might be easier for the Plan Sponsor to offer a money market fund, but is that truly in the best interest of the participants?

Ironically, certain of the risks that are intrinsic to stable value funds also arise in the context of money market funds. That is, money market funds allow for a disparity between book value and market value. Remember the Reserve Fund? It “broke the buck” during the prior financial crisis. Money market funds although ostensibly “safe investments,” present their own risks. There is no such thing as a “risk free” investment.

Global economies are frighteningly fragile these days. Employment prospects for millions of Americans are equally shaky. A participant’s balance in his/her 401(k) plan is not Monopoly money. Retirees are relying on these retirement plans, and many are choosing to invest them in strategies which can compound and grow over the years with lower volatility and risk.

The difference between a fund yielding 2.55%, versus a fund yielding .02% is significant. Plans sponsors, should not casually eliminate stable value programs in favor of money market funds just because stable value is complicated to understand and administer. Rather than taking the easy way out by selecting money market funds, plan sponsors should hire an independent stable value fiduciary to implement and manage the program. Net of any fees, participants will still enjoy investment yields significantly higher than money market funds. And, the sponsors can rest easier at night because true fiduciary experts would be overseeing the investments.

Aren’t plan participants worth it?

Barbara Shegog, CPA, CFA