

MetLife

MetLife Stable Value Study

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A Survey of Plan Sponsors and Stable Value Fund Providers

About MetLife

For over 140 years, MetLife has been one of the country's most trusted financial institutions. We are well-known for providing innovative stable value solutions supported by a strong commitment to customers and the stable value industry. We have a 30-year track record with \$26 billion in stable value business.¹

The MetLife enterprise serves 90 of the top 100 FORTUNE 500®-ranked companies and has over \$539 billion in total assets and over \$505 billion in liabilities.² The operating companies, Metropolitan Life Insurance Company and MetLife Insurance Company of Connecticut, have over \$356 billion in total assets and over \$339 billion in liabilities.³ The top credit rating agencies have repeatedly recognized us for our financial strength and our ability to build capital.⁴

MetLife's extensive experience, diversified book of business, flexibility and underwriting expertise make our company a preferred stable value provider of many retirement plans and stable value managers.

¹ As of December 31, 2009.

² MetLife, Inc. as of December 31, 2009. Total assets include general account and separate account assets and are reported under accounting principles generally accepted in the United States of America.

³ Metropolitan Life Insurance Company and MetLife Insurance Company of Connecticut as of December 31, 2009. Total assets include the general account and separate account assets and are reported on a statutory basis.

⁴ For current ratings information and a more complete analysis of the financial strength of Metropolitan Life Insurance Company and MetLife Insurance Company of Connecticut, please go to www.metlife.com and click on "About MetLife," "Ratings."

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Executive Summary

As worries about the economic crisis and resulting credit market volatility of the last 18 months prompted 401(k) plan participants to seek safety and stability in stable value¹ investments, questions have arisen about how well the current stable value system is holding up. How the financial crisis has affected, among other things, stable value wrap provider stability and capacity, pricing and contract operation, and underlying investment parameters is a topic of considerable discussion throughout the industry among practitioners and public policy-makers alike.

Against this backdrop, MetLife commissioned a quantitative and qualitative stable value study fielded during November and December 2009. The quantitative research was comprised of 145 online interviews with plan sponsors who had significant influence over decisions regarding stable value investment options. This included plan sponsors of all sizes with at least 100 participants in a 401(k) plan, a 457 plan or both plan types that included a stable value option. Plan sponsor respondents represented more than 20 major industries. The qualitative research involved a series of in-depth telephone interviews with stable value fund² providers and consultants actively involved in advising plan sponsors on stable value.

MetLife commissioned this study to gain strategic insight into the current landscape of stable value products, such as:

- > How sponsors access stable value products.
- > How aware sponsors and stable value fund providers are about book guarantee features.
- > What the current perceptions are about the importance and value of various guarantee provisions and wrap contract features.
- > Whether or not there is a gap between what's being communicated between sponsors, stable value fund providers and wrap providers and what's understood.

STABLE VALUE REMAINS A CORNERSTONE OF QUALIFIED RETIREMENT PLANS

Available only in tax-qualified individual account plans, including defined contribution (DC) plans, stable value products seek to maximize returns while preserving principal and, in this latter respect, are similar to money market funds. However, the way stable value achieves this is fundamentally different from money market funds (see page 9), and as a result stable value returns have historically been considerably higher than money market funds. Stable value returns are comparable to those of high-quality, intermediate-term bond funds, but with much lower volatility—an increasingly attractive

1 The term "stable value" in this report in all cases refers to arrangements that qualify for book value accounting according to the rules of SOP 94-4-1. SOP 94-4-1 requires the purchase of "fully benefit responsive investment contracts" (e.g., traditional GICs, separate account GICs or synthetic GICs ["wrap contracts"]).

2 The term "stable value fund" as used in this report references pooled funds established as collective trusts.

option in today's current market environment. With an estimated 27% of 401(k) assets allocated to stable value funds at the end of 2009,³ stable value remains a cornerstone for 401(k) and other qualified individual account plan participants.

UNDERSTANDING STABLE VALUE ARRANGEMENTS IS IMPORTANT

The extraordinary economic events of the last 18 months have served to highlight to sponsors the importance of understanding the arrangements they select. For example, when evaluating a separate account or synthetic guaranteed interest contract (GIC) structure, the number of elements that the fiduciary should consider includes not only the investment strategy and manager, under selection criteria similar to those associated with other investment alternatives, but also the ability and experience of the fixed income manager in managing assets for a stable value program.

With the potential mixture of investment managers, wrap providers and contracts available today, it becomes critical for the plan sponsor to recognize that a variety of different roles can come into play, and to become educated about how those involved in providing stable value solutions see their roles. In a startling finding of this study, only half of stable value providers surveyed consider themselves fiduciaries to the plan. An ERISA fiduciary generally includes any person who has discretionary authority or responsibility in the administration of an employee

benefit plan, including management or disposition of its assets. A seller of a fully benefit responsive investment contract that does not manage plan assets (e.g., an issuer of a traditional or synthetic GIC) is not an ERISA fiduciary.

In addition, sponsors should become familiar with the wide variety of regulations that govern each type of arrangement, variations in wrap contract provisions and guarantees, as well as the more familiar due diligence with regard to investment strategy and guidelines. Considerations include assessing whether or not stable value is a core competency for their book value wrap providers, determining how their book value wrap provider(s) define and handle employer-initiated events and understanding how each wrap provider's contract terminations and related contract provisions work.

STABLE VALUE AT A CROSSROADS?

Notwithstanding the core role that the stable value asset class currently holds across DC plans, the recent economic crisis and resulting credit market volatility have brought the stable value market to a crossroads. Major findings from the study include the following:

Stable value is most frequently accessed through a recordkeeping/full-service provider, but this varies with plan size

The study found that plan size was clearly correlated with the way in which sponsors accessed stable value for their plans, with smaller plans relying

predominantly on a recordkeeper or full-service provider. At the other end of the spectrum, the largest plans were most likely to arrange their stable value offerings directly rather than through a pooled arrangement or recordkeeper. The number of book value guarantee providers also varied with plan size and with direct access. Plans using more than one book value guarantee provider are more likely than those using just one provider to access their stable value offering directly (47% vs. 22%). In contrast, those using a single book value guarantee provider are more likely to use a recordkeeper/full-service provider than are those with multiple book value guarantee providers (57% vs. 25%).

Traditional GICs are both an element in stable value funds offered by stable value fund providers and are also purchased directly by sponsors

Most stable value fund providers reported a range of investment options within their stable value offerings, with about half having more than one investment type. Not surprisingly, synthetic arrangements are the most common element of stable value funds offered by the stable value providers. What may be more surprising is the extent to which these funds also invest in traditional GICs.

Among plan sponsors who offer stable value as an investment option in either their 401(k) or 457 plan, half (50%) indicate they have a traditional GIC, 44% of plans indicate they have a synthetic GIC and one-third of plans (34%) have a separate account GIC. Not surprisingly, the likelihood of

having synthetic and separate account arrangements increases as both total assets under management (AUM) and average amount of stable value AUM in the DC plan increase.

Economic events have triggered changes in investment guidelines

One of the most reported effects of recent market events is “de-risking” of investments by book value wrap providers, so the study asked a series of questions about the extent to which this dynamic had affected plans over the past year. Plan sponsors with separate account or synthetic GICs report that about one-third of their book value guarantee providers implemented a change in investment guidelines in the past 12 months as a reaction to market changes.

A second widely reported issue has been wrap availability in the current market. Among all plan sponsors who have a separate account or synthetic GIC, 24% report that they have replaced a book value guarantee provider within the past 12 months because a provider exited the business. Plan sponsors that work with multiple providers are more apt than those working with just one provider to report that they have needed to replace, in the past year, a provider who left the business by a three-to-one margin, and about 15% of the stable value fund providers said the same. It appears that the nature of the wrap capacity problem is more complex than it may appear, and that it may be less about capacity, per se, than about wrapping the same investment strategies on the same basis as before.

Stable value widely used but not widely understood

Study results suggest that while stable value is widely used, it is not widely understood in an integrated way.

For example, there is a high level of unfamiliarity with how various events are treated by book value guarantee providers—one-third or more of plan sponsors indicated that they don't know how these events are treated for a series of potential events other than plan termination. For the approximately one-quarter to one-third of their wrap providers who consider a series of events to be employer-initiated, plan sponsors are not sure what events can lead to payments at market value. This suggests that these aspects of a stable value offering should be explicitly incorporated into due diligence and evaluation activities. It also appears that the connection between wrap contract provisions and other plan features, such as the investment strategy selected and other funds offered to participants, is not generally viewed on an integrated basis.

Creditworthiness of the guarantee value providers trumps fees as top consideration among both plan sponsors and stable value providers

Study results indicate that all parties—both stable value fund providers and plan sponsors—rate the credit rating of the guarantee provider as their highest priority, effectively reversing the longstanding and traditional attention to fees that had long been the focus of the stable value market. It is very interesting to note, however, that stable value fund providers worry a lot more about the

creditworthiness of book value guarantee providers. While the majority of stable value fund providers (nine out of 13), are “extremely concerned” about the ability of their book value guarantee providers to meet book value obligations, only 7% of plan sponsors express this level of concern. This may be in part due to the heavy reliance that stable value fund providers have on synthetic GICs combined with multiple book value wrap providers needed to offer their funds. Sponsors with relatively fewer wrap providers are aware of the importance of financial strength, but are less likely to have experienced either a wrap provider needing to or wanting to exit the market.

Market events have undoubtedly contributed to this change in perception. The focus on fees was natural when markets were rising, and the risk associated with a book value guarantee was viewed as minimal. And as long as guarantee risk was viewed as minimal by many wrap providers and consultants, greater incentives existed for additional providers to enter the market, further focusing the market on fees. As the economic problems worsened, some financial institutions experienced downgrades and many others that did not refocused on core businesses, which did not include providing wrap guarantees. The sudden awareness among stable value fund providers that both the provisions of guarantees and the strength of those providing them could vary significantly from provider to provider may serve as an impetus for building a broader and deeper understanding about the guarantees associated with this asset class.

Stable Value: What's Offered and How It's Accessed

STABLE VALUE MOST FREQUENTLY ACCESSED THROUGH A RECORDKEEPING/FULL-SERVICE PROVIDER

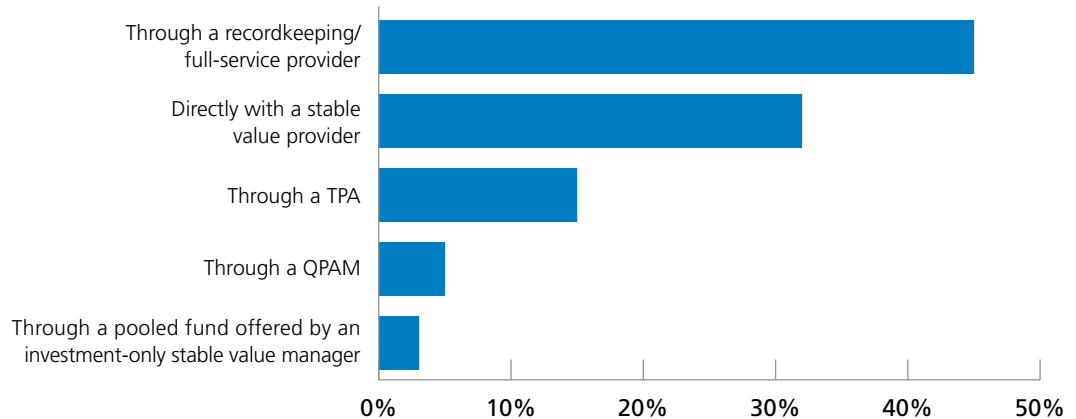
When accessing stable value, plan sponsors indicate that they predominantly access and arrange their stable value offering through a recordkeeper or full-service provider (45%). A little less than one-third (32%) access their stable value offering directly, while 15% of plans access stable value funds through a third-party administrator (TPA).

A small number of plans sponsors (only 5%) use a qualified professional asset manager (QPAM) to access their stable value offering, and even fewer (3%) access stable value through a pooled fund offered by an investment-only stable value manager.

As expected, small plans (those with fewer than 1,000 participants) (50%) and mid-sized plans (those with 1,000 to 4,999 participants) (63%) are more likely to have an arrangement through a recordkeeper or full-service provider than mega plans (those with 10,000 participants or more) (21%). Small plans are also much more likely than mega plans to use TPAs (33% vs. 6%). However, more than half (54%) of mega plans access their stable value offering directly, compared to 17% and 19% of small and mid-size plans, respectively.

Plans using more than one book value guarantee provider are more likely than those using just one provider to access their stable value offering directly (47% vs. 22%). In contrast, those using a single

How Stable Value Products are Accessed and Arranged (All Plan Sponsors, N=145)



book value guarantee provider are more likely to use a recordkeeper/full-service provider than those with multiple book value guarantee providers (57% vs. 25%).

Plans with \$1 billion or more in AUM are much more likely to have directly accessed their stable value offering (63%). Plans with under \$100 million in AUM are twice as likely on average to work through a TPA (31% vs. 15% for all plans). Similarly, plans with a traditional GIC only are more apt than other plans to work through a TPA (24% vs. 10%).

The types of stable value fund providers interviewed for this study are representative of the access arrangements that plan sponsors report. Of the 13 stable value providers interviewed, five are recordkeeping/full-service providers, four are investment-only stable value managers, three are TPAs and one is a QPAM.

MAJORITY OF PLAN SPONSORS WORK WITH ONLY ONE BOOK VALUE GUARANTEE PROVIDER, WHILE STABLE VALUE FUND PROVIDERS WORK WITH SIX, ON AVERAGE

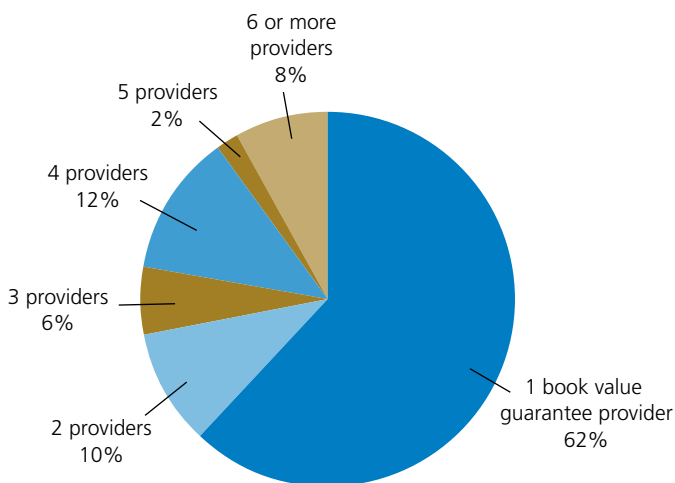
A majority of plan sponsors—over six in ten plan sponsors (62%)—work with just one book value guarantee provider and another one in ten (10%) work with two providers. Two in ten work with three-to-five providers and only 8% work with six or more book value guarantee providers.

Plan sponsors who access their stable value offering directly are less likely than other plans to use just one book value guarantee provider (43% vs. 71%). Plans using only a traditional GIC are also more apt to use just one provider (80% vs. 51%).

In general, and presumably as a result of higher asset levels and risk management procedures, large plans tend to work with more book value guarantee

Number of Book Value Guarantee Providers Used by Plan Sponsors

(All Plan Sponsors, N=145)



providers than small plans. Eighty-seven percent of small plans work with one book value guarantee provider, whereas just 35% of mega plans work with one provider. Nearly half (46%) of mega plans work with four or more book value providers. When size of AUM in the DC plan is considered, just over one-quarter (28%) of plans with \$1 billion or more have just one book guarantee provider compared to 74% of all other plans.

All of the stable value fund providers surveyed work with more than one book value guarantee provider and, overall, the average number of book value guarantee providers used is 6.3. The number of book value guarantee providers that stable value fund providers are currently contracting with ranges from two-to-14. The investment-only stable providers tend to work with a larger number of book value guarantee providers than do TPAs (9.8 vs. 3.7). These estimates

may overstate the number of book value guarantee providers that firms are actively using. For example, an investment-only stable value manager has contracts with 14 providers, but notes that they are only actively working with seven to eight providers.

TRADITIONAL GICS: A BACKBONE OF STABLE VALUE PROGRAMS

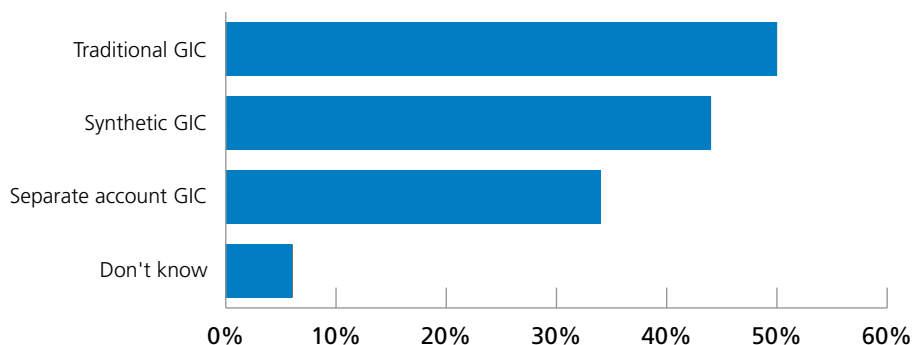
Among plan sponsors who offer stable value as an investment option in either their 401(k) or 457 plan, half (50%) indicate they have a traditional GIC, 44% percent of plans indicate they have a synthetic GIC, and one-third of plans (34%) have a separate account GIC. The largest plans (10,000 or more participants) are more likely than small plans (100 to 1,000 participants) to have a synthetic GIC (56% vs. 30%), as well as a separate account GIC (52% vs. 20%).

Number of Book Value Guarantee Providers Under Contract by Stable Value Fund Providers

Providers	Number of Stable Value Fund Providers (N=13)
2 book value guarantee providers	1
3 book value guarantee providers	2
4 book value guarantee providers	3
5 book value guarantee providers	2
6 to 10 book value guarantee providers	3
More than 10 book value guarantee providers	2
Average	6.3

Types of Stable Value Investment Options Offered by Plan Sponsors

(All Plan Sponsors, N=145)



Not surprisingly, the likelihood of having synthetic and separate account arrangements increases as both total AUM and average amount of stable value AUM in the DC plan increase.

Traditional GICs are both an element in stable value funds offered by stable value fund providers and are purchased directly by sponsors. It's interesting

to note that most stable value fund providers have a range of investment options within their stable value offerings, with about half having more than one investment type. Not surprisingly, synthetic arrangements are the most common element of stable value funds offered by the stable value fund providers. What may be more surprising is the extent to which these funds also invest in traditional GICs.

Stable Value and Money Market: Similar on the Surface, But Not the Same

The purposes of a money market fund are to provide current liquidity, which it does by maintaining an effective duration of about 45 days, and to preserve principal, which it does by maintaining a net asset value of \$1.00. Money market funds operate essentially as demand deposit accounts. When this capability is embedded inside a qualified plan the demand deposit feature might be viewed as a mismatch for the qualified plan. Money market funds carry no guarantees; their ability to deliver on their investment objective relies on how the funds are permitted to invest and the short maturities associated with the permitted investments.

Stable value, on the other hand, has been developed specifically for qualified plans, and generally has an effective average duration of two to three years or more. This is in part possible because, while funds inside a qualified plan may be reallocated, there are very stringent restrictions on funds leaving the plan altogether, which in turn makes investing for a longer time horizon possible and practical. Hence, returns are much higher for stable value funds than for money market funds. After all, liquidity on demand is expensive. On average, stable value returns range from 140% to 160% of those of money market funds, with average returns for stable value and money market over the past 10 years through 2008 of 4.7% and 2.9%, respectively; for 2008, the figures were 4.7% and 2.0%, respectively.⁴

Market Events Are Triggering Changes in Investment Guidelines

One of the most reported effects of recent market events is the “de-risking” of investments by book value wrap providers, so the study asked a series of questions about the extent to which this dynamic had affected plans over the past year.

Plan sponsors with separate account or synthetic GICs report that 36% of their book value guarantee providers have made a change in investment guidelines in the past 12 months triggered by market changes. At the other extreme, one investment-only stable value fund manager said it was difficult to answer because currently all of its book value guarantee providers are trying to change investment guidelines and there is a lot of negotiating in play. A smaller share (21%) of the book value guarantee providers have adjusted investment guidelines in conjunction with a change in the underlying investment managers.

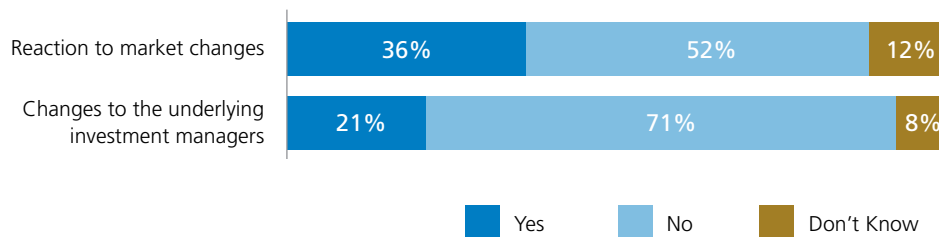
MARKET TO BOOK RATIOS CAN IMPACT INVESTMENT STRATEGIES

Stable value fund providers report that for just over half the book value guarantee providers they use, a significant change in market vs. book value would force a change in their stable value offering’s investment strategy. Plan sponsors report a slightly lower likelihood that their providers would seek to trigger a change in investment strategy, but they also report that they don’t know what more than one-quarter of their book value guarantee providers would do.

According to stable value fund providers, a significant change in market vs. book relationship forces a change in investment strategy more often than not (26 “yes” vs. 20 “no” responses). One recordkeeping/full-service provider did not know

Whether Changes to Investment Guidelines Have Been Triggered in the Past 12 Months by Selected Events: Plan Sponsors

(Book Value Guarantee Providers Used by Plan Sponsors With Separate Account or Synthetic GICs, N=170)



if any of the three providers he uses would force a change. Another recordkeeping/full-service provider commented that although he is not forced to change his stable value offerings' investment strategy for this reason if book value falls relative to market value, it would be of great concern to him because of the impact on credit quality. In that situation, he would likely change investment strategy, although not because he was required to do so.

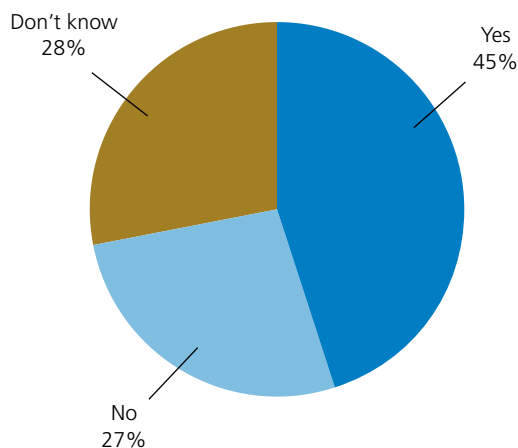
Plan sponsors offering separate account GICs or synthetic arrangements report that for 45% of their book value guarantee providers, a significant change in market vs. book value forces a change in investment strategy; for 27% of providers it does not. Plan sponsors do not know for over one-quarter (28%) of book value guarantee providers.

WRAP CAPACITY EFFECTS NOT AS WIDESPREAD AS EXPECTED, BUT FEES ARE GENERALLY BEING RE-EXAMINED

Another widely reported issue has been around wrap availability in the current market. While some late entrant wrap providers exited early, reducing synthetic and insured wrap capacity especially with regard to riskier investment strategies, among all plan sponsors who have a separate account or synthetic GIC, only 24% report that they have replaced a book value guarantee provider within the past 12 months because a provider exited the business. Plan sponsors who work with multiple providers are more likely than those working with just one provider to report that they have needed to replace, in the past year, a provider who left the business (38% vs. 11%). About 15% of the fund providers said the same.

Whether Significant Change in Market vs. Book Value Would Force a Change to Stable Value Investment Strategy: Plan Sponsors

(Book Value Guarantee Providers Used by Plan Sponsors with Separate Account or Synthetic GICs, N=170)



A related finding tied to market changes is the increased perception of the value of guarantees and, with it, increased fees. Both plan sponsors and stable value fund providers indicated that over the last 12 months the incidence of fee negotiation among book value guarantee providers has far exceeded the frequency of providers who have exited the business.

Overall, about half the stable value fund providers (all the investment-only stable value managers and the QPAM) report that their book value guarantee providers have initiated discussions to renegotiate their fees within the past 12 months.

Among plan sponsors who work directly with their stable value providers and who have at least one separate account or synthetic GIC, nearly two-thirds (62%) report that at least one of their book value guarantee providers has attempted to renegotiate their fees within the past 12 months.

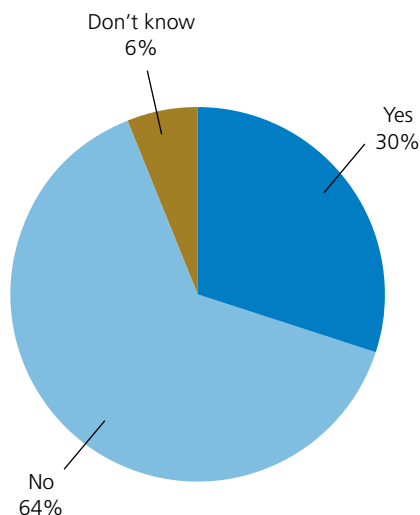
It appears that the nature of wrap capacity concerns are more complex than it may appear, and that it may be less about capacity, per se, than about wrapping on the same basis as before.

Stable value fund providers and plan sponsors differ in the extent to which they think book value guarantee providers make decisions unilaterally when a reaction to market changes forces a shift in investment strategy.

Stable value fund providers say three-fourths of their wrap providers make unilateral decisions, while plan sponsors say only about three in ten do. The likelihood that decisions are made unilaterally by the book value guarantee provider decreases as size of plan increases (whether measured by number of participants or AUM).

Whether Decisions About Changes to Investment Guidelines Are Made Unilaterally by Book Value Guarantee Providers Used by Plan Sponsors

(Book Value Guarantee Providers That Had Investment Guidelines Changed in Past 12 Months, N=70)



Stable Value More Widely Used Than Widely Understood

GAP IN PRACTICAL UNDERSTANDING OF STABLE VALUE MECHANICS

With the potential mixture of investment managers, wrap providers and contracts available today, it has become critical for the plan sponsor to recognize and become educated about variations in contract provisions and differences in what is being guaranteed and under what circumstances, in addition to the due diligence with regard to investment strategy and guidelines that plan sponsors and their investment advisors conduct with any qualified plan investment option. It's also important to understand the wide variety of regulatory regimes that govern each type of guarantee.

The study found a significant gap in the practical understanding of stable value mechanics. For example, one of the investment-only stable value managers manages a pooled fund and does not generally drill down to individual book value contracts—he noted that they had not had a new contract with a book value guarantee provider in six years. A TPA who specializes in Web-based recordkeeping for broker-dealer and registered investment advisor (RIA) firms commented that he is involved extensively in custodial work and that his clients really choose the book value guarantee provider. The QPAM interviewed was not familiar with the details of their book value guarantee provider contracts; prior to the interview, he contacted his sub-advisor to be briefed on many of the issues covered in the survey.

Unfortunately, the unfamiliarity with contract provisions appears to be pervasive. When asked about a slate of events and whether or how these

could affect their stable value offering, as many as one-third of respondents were not sure. As one consultant commented:

"It has really been difficult in our role to have fiduciaries focused on the potentially major features of these funds, and how those features can make a real difference in different markets. Because times were so good and other things were on the front burner, the stable value fund could be an afterthought—it did what it was supposed to do, and it was there because it needed to be there, and that was it."

CONFUSION ABOUNDS AROUND EMPLOYER-INITIATED EVENTS AND TRIGGERS

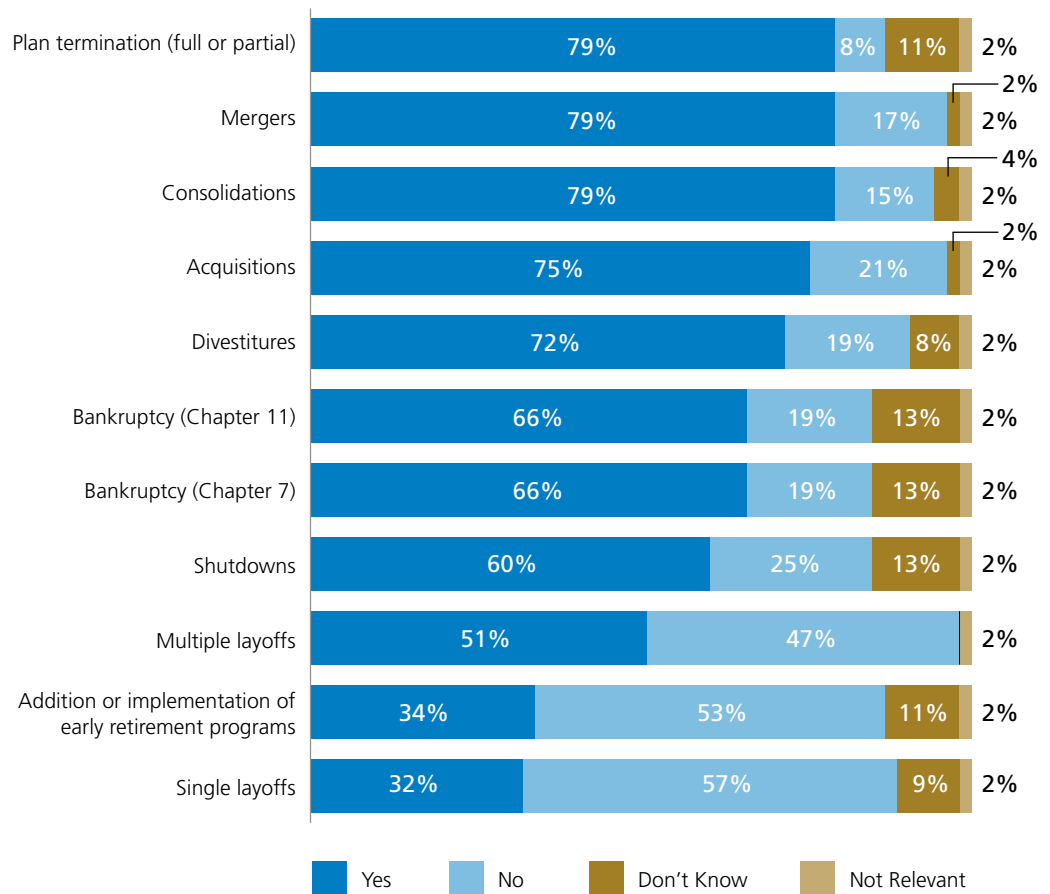
Defining Employer-Initiated Events

For both stable value fund providers and plan sponsors, plan termination is most often considered an employer-initiated event by book value guarantee providers they use—for 79% of providers that stable value fund providers use and 67% of the providers that plan sponsors use.

For most other types of events, at least 60% of the book value guarantee providers used by stable value fund providers consider them to be employer-initiated. Plan sponsors report a lower percentage for the providers they use, in large part because many are unfamiliar with how their book value guarantee providers define employer-initiated events. There is agreement among stable value fund providers and plan sponsors that single or multiple layoffs are among the least likely to be treated as employer-initiated.

Whether Book Value Guarantee Providers Consider Various Events to Be Employer-Initiated: Stable Value Fund Providers

(All Book Value Guarantee Providers Used, N=53)



Plan termination (either full or partial) is recognized as an employer-initiated event for 42 of the 53 (79%) book value guarantee providers that stable value fund providers work with. Similarly, the majority of book value guarantee providers treat mergers, consolidations and acquisitions as employer-initiated events. Nearly as many consider divestitures to be an employer-initiated event. In one case, however, the respondent notes that they would count these types of occurrences as employer-initiated events only if they resulted in an outflow of funds.

Stable value fund providers report that a majority (66%) of book value guarantee providers treat bankruptcy, whether Chapter 11 or Chapter 7, as employer-initiated. It was interesting that respondents did not differentiate between these two circumstances, as the former often does not trigger changes to employment during the reorganization, and the latter dissolves the firm. Nearly as many book value guarantee providers consider shutdowns employer-initiated events (60%).

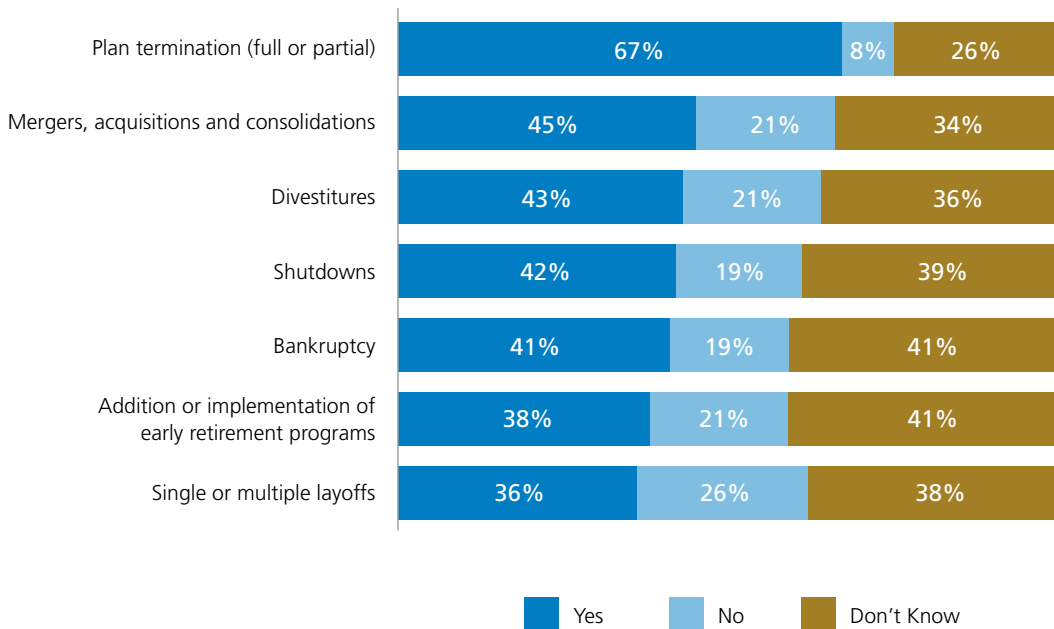
The events least likely to be viewed as employer-initiated by book value guarantee providers are single layoffs (32%) and the addition or implementation of early retirement programs (34%). There is no pattern to how these events are viewed by different types of stable value provider organizations. About half of book value guarantee providers used treat multiple layoffs as an employer-initiated event. One respondent uses a book value guarantee provider who does not use a traditional market value adjustment—a new rate is assigned every two months to keep market and book value in close alignment. If there is an employer-initiated event, there may be a notice of 90 days, but all funds are paid out at book value.

Several respondents volunteered that where they have a negotiated contract template, all their book value guarantee providers do almost everything the same way. A TPA respondent notes that most ERISA-based providers are similar on many of the dimensions explored in the survey, including which events are considered employer-initiated, but drew a distinction with the non-ERISA provider they use, which primarily serves the government. That entity has no contract rules and events are typically triggered at the employee, rather than at the employer level.

Plan sponsors report that plan termination (either full or partial) is considered to be an employer-initiated event for two-thirds (67%) of the book

Whether Book Value Guarantee Providers Consider Various Events to Be Employer-Initiated: Plan Sponsors

(All Book Value Guarantee Providers Used, N=237)



value guarantee providers they work with. Fewer than one in ten providers used (8%) do not consider plan termination to be an employer-initiated event. Plan sponsors are unable to say whether or not plan termination is an employer-initiated event for about one-quarter (26%) of the book value guarantee providers used.

According to plan sponsors, the other situations asked about in the survey are considered to be employer-initiated for roughly four in ten book value guarantee providers used. For example, 45% of providers treat mergers, consolidations and acquisitions as employer-initiated events. Nearly as many (43%) book value guarantee providers also consider divestitures to be employer-initiated events. Forty-two percent treat shutdowns as employer-initiated and a similar proportion (41%) regard bankruptcy the same way. Slightly fewer consider the addition or implementation of early retirement programs (38%) or single/multiple layoffs (36%) to be employer-initiated.

It should be noted that the level of unfamiliarity with how various events are treated by book value guarantee providers runs high—at least one-third or more for each of the events other than plan termination.

Treatment of Employer-Initiated Events

Stable value fund providers report that, for events considered employer-initiated, whether the book value guarantee provider can use that event to trigger a payment other than book value depends on the event, with about two-thirds indicating that this applies to plan terminations, mergers and consolidations, but fewer than half indicating that this is the case for events such as bankruptcies, shutdowns or layoffs.⁵ Plan sponsors are less likely to believe that their book value guarantee providers can use an employer-initiated event to force a payment other than book value—for most employer-initiated events, plan sponsors say that just over half of their providers can do so.

Several stable value fund providers report that their book value guarantee providers say they can use an employer-initiated event to trigger a payment other than book value, but whether they do so depends on whether the “corridor”⁶ has been exceeded. Under these contracts, the first 20–30% is paid at book value, but outside of that corridor, payments are made at market value. One respondent says that mergers, consolidations and acquisitions can trigger a payment other than book value, but only if the client closes the contract.

⁵ It is important to bear in mind that these events might lead to sufficiently rapid and extensive loss of employment as to qualify as “partial plan terminations.”

⁶ Corridor is a contractual provision that restricts the percentage of a contract that may be paid out at book value for certain employer-initiated events.

Whether a Payment Other Than Book Value Could be Triggered by Employer-Initiated Event: Stable Value Fund Providers

(Among Book Value Guarantee Providers Used Who Consider Event to be Employer-Initiated N=53)

Employer-Initiated Event	Yes	No	Don't Know	Not Applicable
	<i>(Percentage of book value guarantee providers)</i>			
Plan termination (full or partial)	62%	9%	8%	21%
Mergers	60%	11%	8%	21%
Consolidations	60%	11%	8%	21%
Acquisitions	57%	11%	8%	25%
Divestitures	53%	9%	8%	30%
Bankruptcy (Chapter 11)	47%	11%	8%	34%
Bankruptcy (Chapter 7)	47%	11%	8%	34%
Shutdowns	45%	8%	8%	40%
Multiple layoffs	38%	6%	8%	49%
Addition or implementation of early retirement program	21%	6%	8%	66%
Single layoffs	19%	6%	8%	68%

In the case of a non-ERISA provider, there can be surrender charges at the group plan, but not at the individual level in the event of shutdowns, plan termination or early retirement programs.

Of the seven types of employer-initiated events that plan sponsors were asked about, a payment other than book value can be triggered most often for plan termination—for 61% of the book value

guarantee providers they use. Among wrap providers that do have a book value payment triggered by plan termination, about half the time it is permitted within a limit (e.g., within the established corridor), as opposed to being done across the board. Note that for about one-quarter of these providers, plan sponsors do not know whether that event could allow a payment at other than book value.

Whether a Payment Other Than Book Value Could be Triggered By Employer-Initiated Event: Plan Sponsors

(Among Book Value Guarantee Providers Used Who Consider Event to be Employer-Initiated)

Employer-Initiated Event	Yes (net)	Yes, in all cases	Yes, but permitted within a limit	Yes, unspecified	No	Don't Know
	<i>(Percentage of book value guarantee providers)</i>					
Plan termination (full or partial) (N=158)	61%	25%	30%	6%	13%	26%
Mergers, acquisitions and consolidations (N=107)	56%	12%	41%	3%	18%	26%
Divestitures (N=102)	56%	15%	37%	4%	13%	31%
Shutdowns (N=96)	53%	16%	33%	4%	12%	35%
Bankruptcy (N=96)	53%	27%	22%	4%	15%	32%
Addition or implementation of early retirement programs (N=89)	54%	13%	36%	4%	16%	30%
Single or multiple layoffs (N=86)	44%	13%	24%	5%	26%	30%

Plan sponsors report that over half of the wrap providers (who consider the respective event to be employer-initiated) have contractual provisions that can trigger a payment other than at book value: mergers, acquisitions and consolidations (56%); divestitures (56%); addition or implementation of early retirement programs (54%); shutdowns (53%); and bankruptcy (53%). For all but bankruptcy, it is at least twice as likely for the payment at book value to have some limitations as opposed to being made

in all cases. For one-quarter to one-third of these employer-initiated events, it is not known whether a payment other than book value can be triggered.

Just under half (44%) of plan sponsors report that book value guarantee providers who consider single or multiple layoffs to be employer-initiated events say that those types of events can allow for a payment other than book value, compared to one-quarter (26%) who say they would not.

Importance of Provisions Associated With Book Value Guarantee Providers

Both stable value fund providers and plan sponsors view the credit rating of the book value guarantee provider as the most important provision—about half of stable value fund providers and six in ten plan sponsors rate this provision as “extremely important.”

For stable value fund providers, termination provisions are rated nearly as high; in contrast, they place the least amount of importance on willingness to allow competing funds. Fee levels rank second in importance for plan sponsors, but just over one-third feels they are “extremely important.” Plan sponsors place the lowest priority on the events that are defined as employer-initiated and having control over changes to investment guidelines.

CREDITWORTHINESS IS TOP OF MIND

The study asked about a variety of stable value wrap provisions. With an average rating on a 5-point scale of 4.4, stable value fund providers consider the credit

rating of the book value guarantee provider as the most important provision, followed by termination provisions (average rating = 4.2). Ratings are somewhat lower for the events which are defined as employer-initiated and for fee levels (average ratings for both are 3.7). Less importance is placed on having control over the changes to the investment guidelines and willingness to allow competing funds (3.3 and 3.0, respectively). An investment-only stable value manager noted that while he thinks that having control over the changes to the investment guidelines and fee levels are very important considerations, he says that “we’re in an environment now where guidelines are 100% wrap provider driven,” so he does not think that providers have much likelihood of changing what wrap providers put in front of him. He says that fee levels used to be a way to differentiate among wrap providers, but now “fees are what they are and we have to take them—there are not a lot of places to turn.”

Importance of Provisions Associated with Book Value Guarantee Providers Used by Stable Value Fund Providers

(Ratings based on 5-point scale, where 5 = Extremely Important, 4 = Very Important, 3 = Somewhat Important, 2 = Not Very Important, and 1 = Not at all Important)

Provisions	Average Ratings for All Stable Value Fund Providers (N=13)
Credit rating of book value guarantee provider	4.4
The termination provisions	4.2
The events which are defined as employer-initiated events	3.7
Fee levels	3.7
Having control over the changes to the investment guidelines	3.3
Willingness to allow competing funds	3.0

Eight stable value fund providers rated at least two of the provisions as “extremely important.” Of those respondents, half said that credit rating of the book value guarantee provider is the most critical provision. A recordkeeping/full-service provider notes that credit ratings are critical because “this is what my clients are paying for.”

Plan sponsors view the credit rating of the book value guarantee provider as the most important provision at a nearly universal 94%—six in ten (61%) feel it is “extremely important” and 32% say it is “very important.” Fee levels rank next in importance (82% important), but a significantly lower proportion

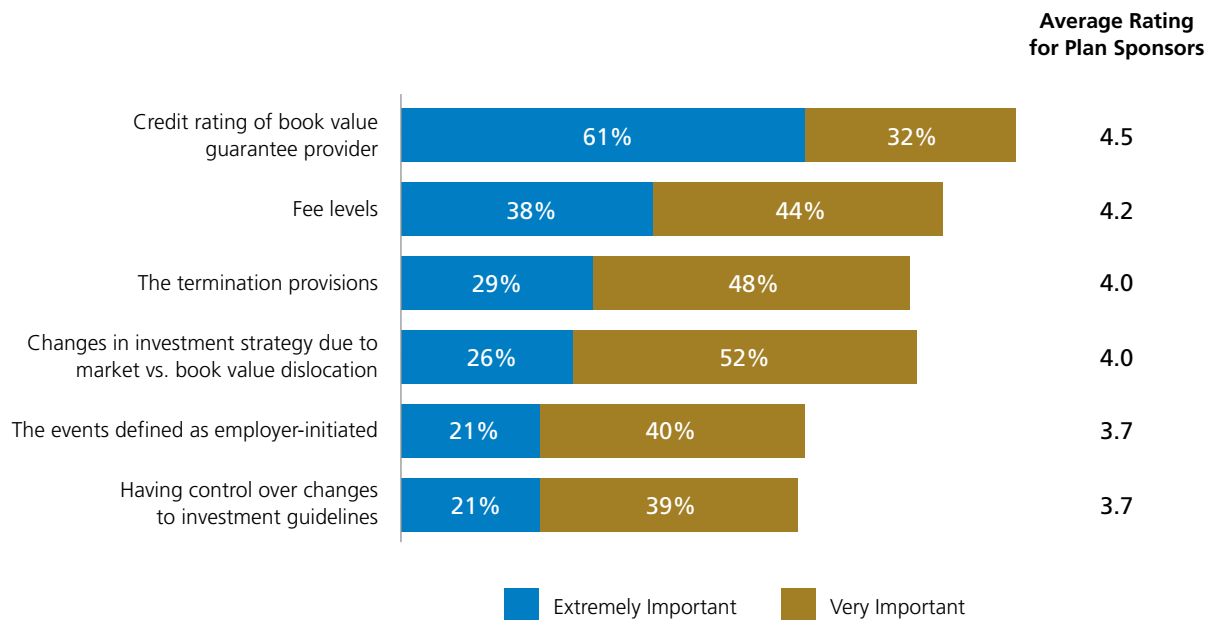
(38%) believe fee levels are “extremely important.” Both termination provisions and changes in investment strategy due to market versus book value dislocation come in next—“extremely” and “very important” ratings combined are at 77% for both of these provisions. About six in ten rate the events which are defined as employer-initiated and having control over the changes to the investment guidelines as “extremely” or “very important” (61% and 59%, respectively).

Over three-fourths of plan sponsors (77%) rate at least two of the provisions as “extremely important.” Of those respondents, about half (53%) identify the

Importance of Provisions Associated with Book Value Guarantee Providers Used by Plan Sponsors

(All Plan Sponsors, N=145)

(Ratings based on 5-point scale, where 5 = Extremely Important, 4 = Very Important, 3 = Somewhat Important, 2 = Not Very Important, and 1 = Not at all Important)



credit rating of the book value guarantee provider as the most critical provision. The termination provisions come in next at 13%, followed by fee levels at 12% and having control over the changes to the investment guidelines at 11%.

Mega plan sponsors are more inclined than small plans to view provisions associated with employer-initiated events (75% vs. 43%), termination provisions (88% vs. 63%) or changes in investment strategy due to market versus book value dislocation (88% vs. 63%) as important.

The perceived importance of the events which are defined as employer-initiated events, termination provisions and changes in investment strategy due to market vs. book value dislocation increase as average AUM in the DC plan increases.

Plan sponsors who use more than one book value guarantee provider are more apt than those who use just one provider to view the following provisions as important: the events which are considered employer-initiated (73% vs. 53%) and having control over the changes to the investment guidelines (75% vs. 50%).

APPLICABILITY OF TERMINATION PROVISIONS⁷

For stable value fund providers, the book value wind down mechanism is the termination provision that most often applies, by a wide margin over other

termination provisions, to their book value guarantee provider contracts. Plan sponsors most often identify guaranteed book value payout at termination as the leading applicable termination provision, but nearly as many also believe the book value wind down mechanism applies. The level of “don’t know” responses is generally between 40-50% for plan sponsors.

Of the 50 providers used by stable value fund providers, the termination provision that most often applies to book value guarantee providers is the book value wind down mechanism—67% of providers used have this termination provision. An investment-only stable value respondent refers to this provision as “immunization,” but only one of the five providers this respondent reported on has this termination provision.

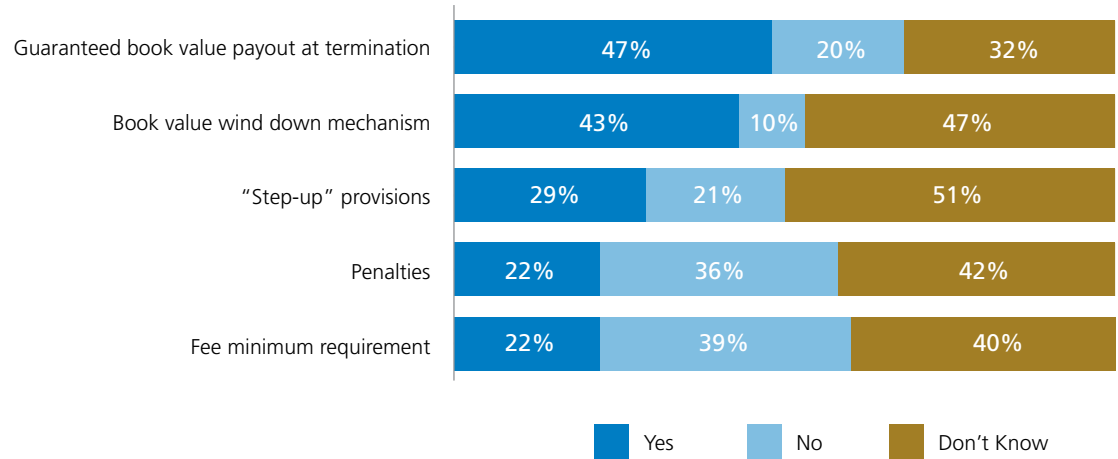
The extent that guaranteed book value payout at termination applies as a termination provision is mixed—it is a termination provision for 18 providers (37%), does not apply for 21 (43%), and it is not known for five (10%). One respondent reports that it depends on who makes the termination decision, noting that there is not a specific mechanism in place for this circumstance.

Fee minimum requirements and penalties apply as termination provisions for a minority of book value guarantee providers (34% and 20% of providers, respectively); it is far more common for both of these provisions to be absent from stable value provider contracts.

⁷ The right to liquidate the contract and receive market value at any time, subject to a repayment of any outstanding withdrawal advances or wrap fees. In the event the contract is terminated before the minimum holding period the investor must pay the wrap provider the net present value of the fees which would otherwise have been paid (Source: *The Handbook of Stable Value Investments*, Frank J. Fabozzi, Frank J. Fabozzi Associates, 1998).

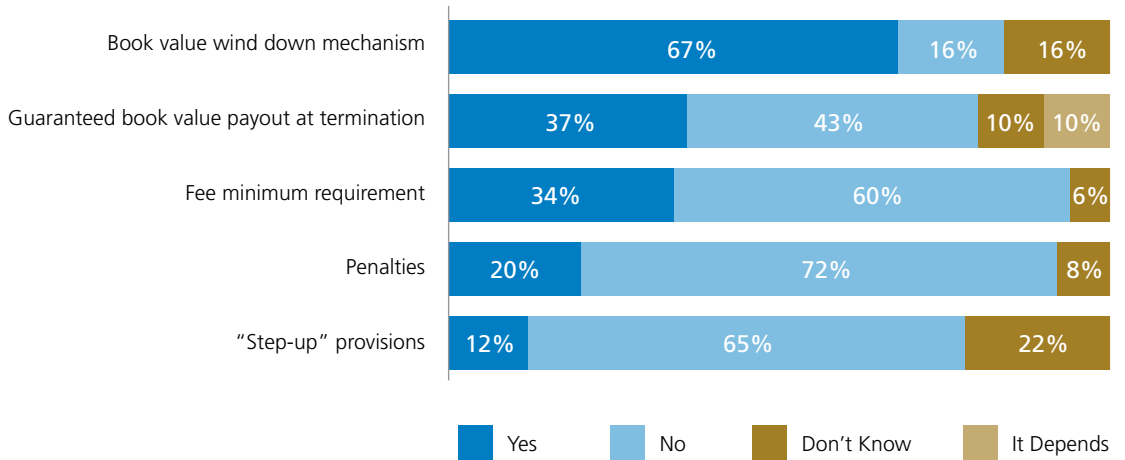
Whether Termination Provisions Apply for Book Value Guarantee Providers Used by Plan Sponsors

(All Book Value Guarantee Providers Used, N=237)



Whether Termination Provisions Apply for Book Value Guarantee Providers Used by Stable Value Fund Providers

(Among Book Value Guarantee Providers with Separate Account or Synthetic GICs, N=50)



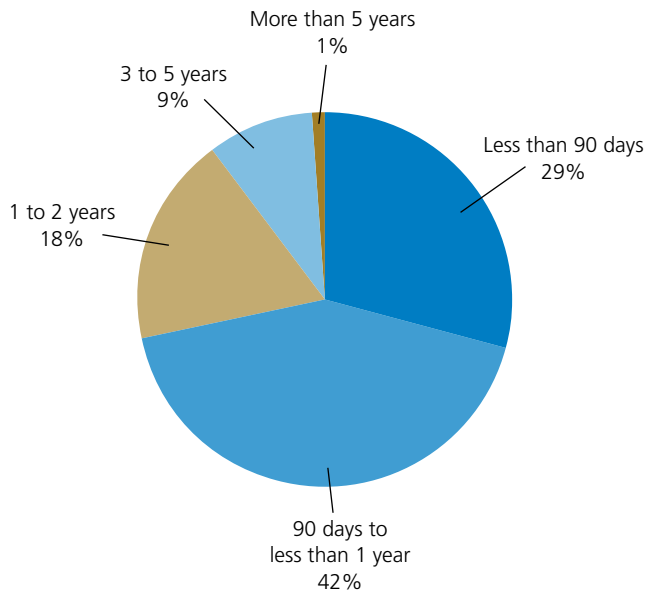
"Step-up"⁸ provisions" rarely occur as a termination provision—only 12% of stable value fund providers use any book value guarantee providers with this provision. Several respondents can't say whether step-up provisions are in effect for the book value guarantee providers they use. An investment-only stable manager observes that their providers have moved away from assumption of coverage provisions in the last year.

TIME FRAME FOR RETURNING ASSETS AT BOOK VALUE

Both stable value fund providers and plan sponsors report that only a small minority of book value guarantee providers have a long time frame for returning the DC plan's assets at book value if contract termination takes place. Both groups indicate that only about 10% of book value guarantee providers can take three-to-five years, with almost none taking longer.

⁸ Remaining book value guarantee providers will increase their coverage if another issuer fails to meet its obligations.

Time Frame for Returning Assets at Book Value if Contract Termination Takes Place: Plan Sponsors
(All Book Value Guarantee Providers That Have at Least One Applicable Termination Provision, N=163)



Stable value fund providers report that if contract termination takes place, plan assets must be returned at book value in less than 90 days for 11 of their book value guarantee providers. Eleven providers are also required to do so in 90 days to less than a year. The timeframe is longer for other providers—one-to-two years for four providers and three-to-five years for five providers.

One respondent said the time frame is not set for any of the providers they work with; when they go into a wind down mode, it is based on the duration of the synthetic arrangements, which is usually two-to-three years. According to the respondent, they monitor the market-to-book value ratios, as well as the credit ratings of book value guarantee providers, on a daily basis. The QPAM respondent said that for four of its five providers the time frame is based on the duration of the underlying assets at the time notice for the wind down is given; for the other provider, it is based on the duration of the index once notice for the wind down is given.

According to plan sponsors, if contract termination takes place, plan assets must be returned at book value in less than 90 days for 29% of their book value guarantee providers. Respondents report that 42% of providers are also required to do so in 90 days to less than a year. The timeframe is longer for other providers—one-to-two years for 18% of providers and three-to-five years for 9% of providers. Only one book value guarantee provider has a time frame of more than five years.

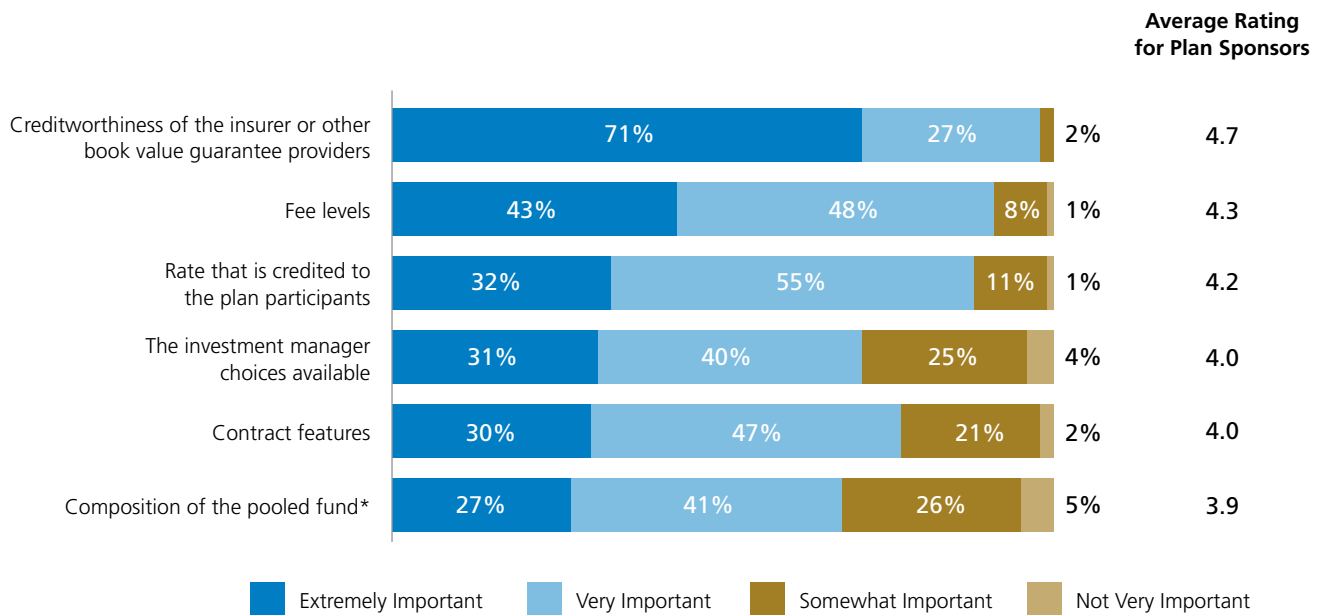
It's important to note that with synthetic arrangements, the wrap providers are not actually holding assets. In this case, the securities are in a custody account and are owned by the plan, and the wrap account is just a financial contract attached to that block of assets, so the book value guarantee providers do not "return" anything. When a wrap contract is terminated in this case, the equivalent factors include the need to replace the guarantee provider, the extent to which the replacement provider is willing to wrap the existing assets, and the asset repositioning that may be required as a condition of new wrap coverage.

Due Diligence Selection Criteria Focus More on Creditworthiness, Less on Contract Provisions

In an earlier section, this study examined responses about the perceived importance of particular stable value wrap features among plan sponsors and stable value fund providers. In addition to this, the study also focused on which aspects of stable value are currently viewed as most important in the due diligence process, both from the viewpoint of a plan sponsor and of a stable value fund provider. These questions focused both on relative value and on comparative importance.

It's important to note that, for a sponsor, due diligence applies at the *stable value program* level. Three of these factors were the same for both—creditworthiness of the book value wrap provider, fee levels, and contract features. Other factors applicable to the arrangement—the rate credited to participants, investment choices available, and the composition of the pooled fund, if applicable—differed from those applicable to the fund provider, where additional features included underwriting and investment constraints.

Importance of Factors When Considering Stable Value Providers: Plan Sponsors (All Plan Sponsors, N=145 except where noted)



*Note: N=99 non-directly accessed plans

CREDITWORTHINESS OF THE INSURER OR OTHER BOOK VALUE GUARANTEE PROVIDERS TRUMPS FEES AS TOP CONSIDERATION AMONG PLAN SPONSORS AND STABLE VALUE FUND PROVIDERS

Nearly all plan sponsors (98%) cite the creditworthiness of the insurer or other book value guarantee providers as important far more often than they do for any other factor (71% of plan sponsors rate this factor as “extremely important,” another 27% rate the factor as “very important”). In fact, of the plan sponsors that rate one or more factors as “extremely important,” 59% rate creditworthiness as the most important factor of all. Creditworthiness also received the highest average score (on a 5-point scale), at 4.7.

Fee levels follow with 91% of plan sponsors rating this selection factor as “extremely important” (43%)

and “very important” (48%). However, of the plan providers who rate one or more factors as “extremely important,” just 8% rate fee levels as the most important factor of all. Two years ago, fee levels would have likely been rated first in importance as a consequence of what had become, at that time, a highly commoditized wrap market.

In contrast, only roughly three in ten plan sponsors rate as “extremely important” the rate that is credited to the plan (32%), investment management choices available (31%), contract features (30%), or composition of the pooled fund (27%). Among these factors, the credited rate is most often rated as at least “very important.” Small minorities of those rating any of these factors as “extremely important” rate it as the most important factor of all. Consistent with this, average scores for these factors ranged from 4.2 to 3.9.

Today’s stable value guarantees can vary significantly from one another as well as by the type of structure selected. Some of the key areas to be included in executing this type of due diligence process might include the following:

- > *Is stable value a core competency of the provider?*
- > *What are the issuer’s termination rights?*
- > *How does the provider handle changing market conditions?*
- > *How does the provider define and handle employer-initiated events?*
- > *Does the wrap provider have termination fees or penalties?*
- > *How does the provider handle contract termination?*
- > *How is the provider/wrap provider regulated?*

Importance of Factors When Selecting Book Value Guarantee Providers: Stable Value Fund Providers

(Ratings based on 5-point scale, where 5 = Extremely Important, 4 = Very Important, 3 = Somewhat Important, 2 = Not Very Important, and 1 = Not at all Important)

Factors	Average Ratings for All Stable Value Fund Providers (N=13)
Creditworthiness of the insurer or other book value guarantee providers	4.9
Contract features (e.g., termination provisions, employer-initiated events)	4.2
Level of investment risk constraints	4.2
Level of underwriting risk constraints	4.2
Fee levels	3.4

Among stable value providers, the most important book value guarantee selection factor is the creditworthiness of the insurer or other book value guarantee providers—nine out of 13 rate this factor “extremely important,” and an average rating of 4.9. According to one recordkeeping/full service provider:

“The creditworthiness of book guarantee providers has become increasingly important due to market conditions and heightened awareness on the part of clients.”

Tied at the next tier of importance were contract features (note that, for this question, contract features was a general category), level of investment risk and underwriting constraints—these factors all receive average ratings of 4.2. Fee levels receive somewhat lower ratings, on average.

Among those who rated more than one factor as “extremely important,” two are unable to say which is more critical. The “tie breaker” question did identify creditworthiness as most important for two providers and the level of investment risk constraints as most important for another two.

ONLY HALF OF STABLE VALUE FUND PROVIDERS CONSIDER THEMSELVES FIDUCIARIES

About half of stable value fund providers consider themselves fiduciaries to the plans they work with. The QPAM respondent and three of the four investment-only stable value managers regard themselves as fiduciaries. A recordkeeping/full service provider respondent sometimes regards himself as a fiduciary, depending on the role his firm is playing in a particular plan. Another investment-only stable value manager says that he is a fiduciary only on the fully discretionary accounts; he notes that:

“Technically, the plan is the fiduciary and their responsibility is to hire us as the manager. We have fiduciary responsibility when we hire another manager.”

DUE DILIGENCE PROCESS ALSO FOCUSES ON CREDIT RATING

When stable value fund providers were asked to describe the due diligence process they follow for the selection and replacement of book value guarantee providers, a common theme is that they start with the credit rating of the entity. Plan sponsors are most apt to mention that they rely on a third party consultant or advisor.

Several stable value fund providers mentioned that they conduct an ongoing credit analysis of the book value guarantee providers on a monthly or quarterly basis. Some also say they evaluate the size and longevity of the entity’s book value wrap business. A few respondents were not able to provide much insight for this question, either because they delegate that role to their sub-advisor, or because they have not yet needed to go through the process of replacing a book value guarantee provider.

“We look at their creditworthiness—who is issuing the wrap. What is their mechanism for coming up with the credited rates, what are their termination criteria? When do participants get book value vs. market value? All those things. There is no benchmark to compare them to as far as performance goes. You just have to understand what it is that you’re buying.” (TPA)

“It starts with the credit research team. Have a standard bidding contract for terms and specifications. Providers come back with quotes and then we select the best combination available. Now there is a big question of capacity. The number of bids is very plan specific. We’re only getting one or two bids back now when put out bid.” (Investment-only stable value manager)

Due Diligence Process: Plan Sponsors

Top Responses (Open-ended/Volunteered responses)	Percent of Plan Sponsors
Rely on third party investment advisor/consultant	50%
Reviewed by internal board or committee	22%
Review investment policy	16%
Rely on investment manager	14%
Review creditworthiness	13%
Review on quarterly basis	10%
Rely on recordkeeper	5%

“There are several facets to it. First is the credit quality of the wrap provider—that’s a complex and comprehensive process to give ourselves assurance that this firm has the financial wherewithal to live up to its obligations. The second category is administrative facility. We only want to deal with wrap providers who have the ability to interact with on an appropriate basis—most of our stuff is done electronically. Third is a commitment to the business—we don’t want ‘fly by night’ wrap providers. Fourth are contractual terms that must meet all our normal requirements, including investment guidelines. Fifth and final is fees.” (Investment-only stable value manager)

“We use an internally created credit rating metric, in addition to the agency credit ratings. We put providers into different tiers, like Tier 1, Tier 2, Tier 3, and try to have more in Tier 1 than in the lower tiers. We dedicate an analyst to this effort. So we’re more proactive than just relying on the credit rating agencies.” (Recordkeeping/full service provider)

“We review a number of factors including creditworthiness, investment management, history of stewardship, compliance to regulations, historical performance, brand name and corporate stability.” (Recordkeeping/full service provider)

Plan sponsors were also asked to describe (in an open-ended question) the due diligence process they follow for the selection and replacement of book value guarantee providers. The most common response given (50%) is that they rely on an independent third party provider such as an advisor or consultant. Fewer cite that there is a review by an internal committee or board (22%). Sixteen percent say that they review the investment policy of the provider, and 14% and 13%, respectively, rely on the investment manager or a review of creditworthiness. Ten percent review provider performance on a quarterly basis and 5% report that they rely on the recordkeeper.

ONGOING COMMUNICATION BETWEEN SPONSORS AND STABLE VALUE FUND PROVIDERS MAY SIGNAL A GAP BETWEEN WHAT’S BEING COMMUNICATED AND WHAT’S UNDERSTOOD

Despite the importance of creditworthiness, this area is not the one monitored most often by either stable value fund providers or plan sponsors. Plan sponsors monitor asset manager performance most frequently and stable value fund providers pay closest attention to their market-to-book value ratio.

Almost all stable value fund providers surveyed monitor their market-to-book value ratio quarterly or more often; many say they monitor it monthly. Nearly as many also say they monitor the credit rating of book value guarantee providers quarterly if not more often.

About two-thirds of plan sponsors (67%) monitor asset managers quarterly or more often. Market-to-book value ratio is monitored quarterly or more often by 60% of all plan sponsors. In contrast, credit ratings of book value providers are monitored at least quarterly by only 51% of plan sponsors.

The smallest and largest plans differ significantly in their monitoring frequency, at 43% and 88%, respectively, monitoring their asset managers quarterly or more often. Small plans tend to monitor market-to-book value ratio on an annual or less frequent basis (40% of small plans monitor annually or less often), and by comparison 85% of the largest plans monitor the ratio at least quarterly. Finally, two-thirds (67%) of the largest plan sponsors monitor the credit ratings of their book value providers at least quarterly, versus 40% of small plans.

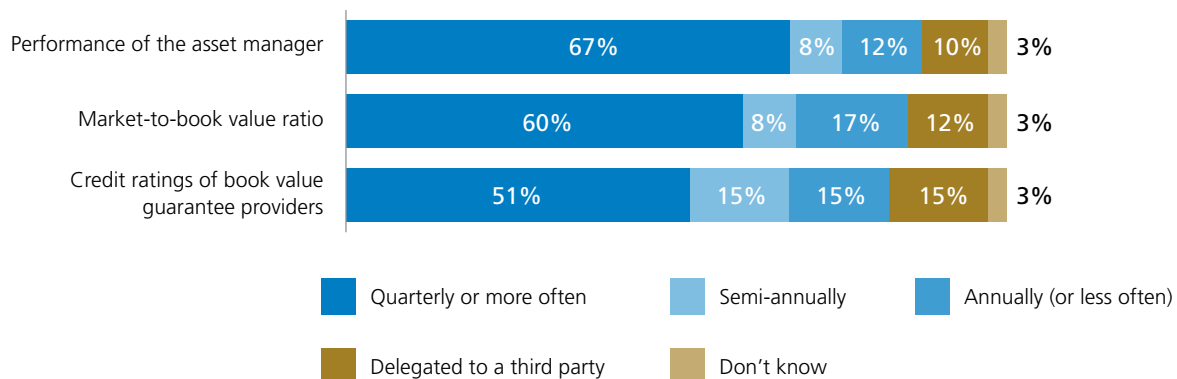
Monitoring frequency also tends to increase as average AUM in the DC plan increases. Plan sponsors using multiple providers are more likely

than those using just one provider to monitor their market-to-book value ratio (75% vs. 51%) and asset manager performance (78% vs. 60%) at least quarterly. Interestingly, plan sponsors with a traditional GIC as part of their stable value fund only are less apt than other plan sponsors to engage in frequent monitoring of their separate account or synthetic GICs on at least a quarterly basis: market-to-book value ratio (42% vs. 71%); creditworthiness (36% vs. 60%); and asset manager performance (44% vs. 80%).

Most stable value fund providers report that information about creditworthiness and market-to-book value ratio is generally communicated to plan sponsors on at least a quarterly basis. However, just over half of plan sponsors feel that information about the credit ratings of book value guarantee providers is communicated to them that often. Plan sponsors are more apt to hear at least quarterly about market-to-book value ratios or the identification of book value guarantee providers.

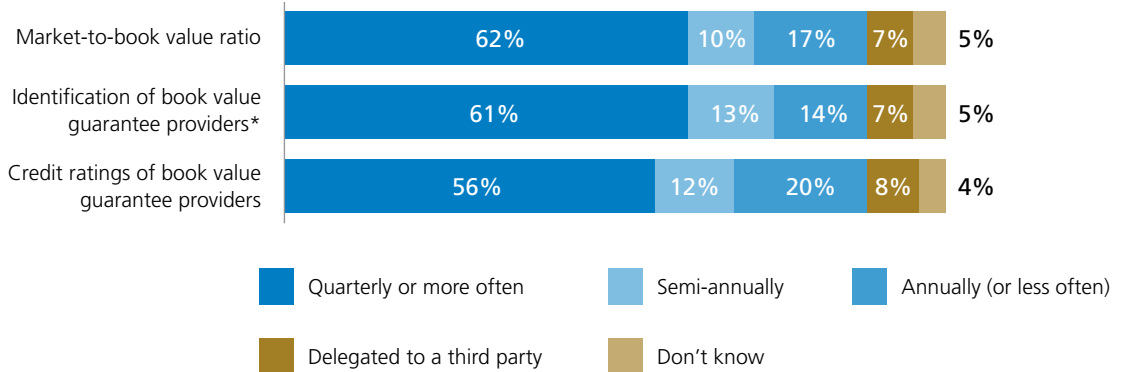
Frequency of Monitoring Book Value Guarantee Providers and Stable Value Fund Providers: Plan Sponsors

(N=145 Plan Sponsors)



Frequency of Communication to Plan Sponsors

(N=145 Plan Sponsors except where noted)



*Note: N=99 non-directly accessed plans

Most stable value fund providers say they communicate both market-to-book value ratio and credit ratings of book value guarantee providers to plan sponsors quarterly or more often. Somewhat fewer (8%) assert they communicate the identification of book value guarantee providers quarterly or more often.

Close to two-thirds of plan sponsors receive information pertaining to market-to-book value ratios and get information identifying book value guarantee providers at least quarterly. Just over half (56%) of plan sponsors receive information pertaining to the credit ratings of their book value guarantee providers at least quarterly.

Among all plan sponsors, regardless of how stable value is accessed, a much larger proportion of the largest plan sponsors (79%) receive information about market-to-book value ratios at least quarterly, versus 40% of small plans. Similarly, 71% of the largest plans receive information about creditworthiness at least quarterly, compared to 37% of small plans. For all three issues, likelihood of receiving information on a quarterly or more frequent basis increases as average AUM in the DC plan increases. Plan sponsors with a traditional GIC only are less likely than other plan sponsors to receive information on these issues quarterly or more often.

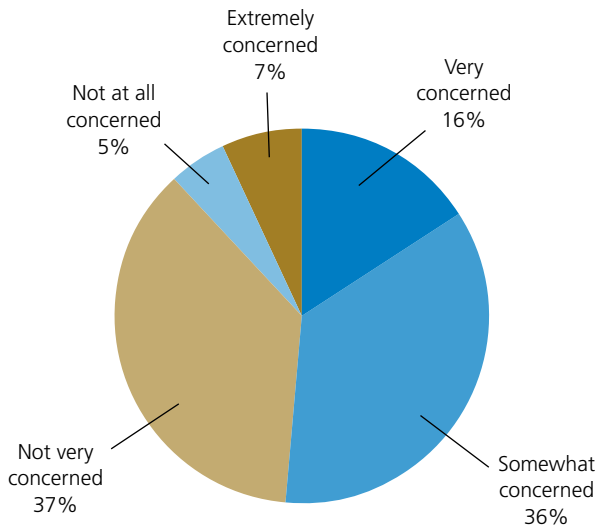
Stable value fund providers are also more concerned than plan sponsors about book value guarantee providers' ability to meet obligations. When asked how concerned they are about the ability of their book value guarantee providers to meet book value obligations, nine out of 13 stable value fund providers report they are "extremely concerned." This includes all of the TPAs and recordkeeping/full-service providers. A recordkeeping/full-service provider explains his high degree of concern over this issue as follows:

"If providers cannot make their book value obligations, then what is the point of anyone using the stable value option? They might as well go to a short-term bond fund."

The remaining stable value fund providers are less concerned about the ability of their book value guarantee providers being able to meet book value obligations. One of these respondents (an investment-only stable value manager who wholesales funds to other recordkeepers) notes that he still pays a lot of attention to this issue, but much less than he did a year ago now that the government is more involved. Another investment-only stable value manager is only "somewhat concerned" because most of their contracts are at or above par.

Level of Concern About Ability of Book Value Guarantee Provider(s) Used by Plan Sponsors to Meet Book Value Obligations

(All Plan Sponsors, N=145)



Having managed through the recent crisis, they aren't that concerned right now. The QPAM believes it is unlikely that his book value guarantee providers will run into difficulty because he has confidence in the underlying health of the investments.

When plan sponsors were asked how concerned they are about the ability of their book value guarantee providers to meet book value obligations, only 7% report they are "extremely concerned" and another 16% say they are "very concerned." Over one-third (36%) are "somewhat concerned," leaving about 41% who are not concerned (37% "not very" and 5% "not at all concerned").

STABLE VALUE AS QDIA OPTION

Participant account losses due to the current economic crisis have brought the potential role for stable value as a Qualified Default Investment Alternative (QDIA) for auto-enrollment into the spotlight.

Unlike large plans, the majority of which have already adopted auto-enrollment, and with it, an approved QDIA such as target date fund, small plans indicate a significant likelihood of implementing stable value as their default, if it were an approved QDIA. This is also

reflected in the responses from the stable value fund providers that serve small plans, most of whom think that if stable value were approved as an additional QDIA, their clients would adopt it as a default for their plans.

Stable value fund providers most often say their clients would be "very likely" to adopt stable value if it were offered as a QDIA because it would be a low-risk choice and lower their clients' liability. Some also feel that stable value is better than the current QDIA choices. For example, stable value funds have less volatility, lower fees, are easier to understand, and have better performance than target date funds. A recordkeeping/full-service provider notes that his clients would be "very likely" to adopt stable value as their QDIA because they had previously used it and liked it. He also thinks the high disclosure associated with stable value makes it an attractive QDIA option. Another recordkeeping/full-service provider is a little less optimistic about his clients adopting stable value as their QDIA option because stable value funds are a little less conservative than money market funds, assuming both would be approved as QDIA options.

Stable value fund providers serving large plans note that there is too much inertia since most of these plans already have established their QDIA.

"A lot of plans, prior to QDIA requirements coming out, did elect for stable value funds to be their default election and they liked it. I think there would be a lot of takers if it fell under the guidelines. Personally, I like stable value because I don't like target funds. I don't like the exposure inside of them or their fees. A lot of the time, I don't like their performance. When I run analytics on the performance of target date funds, they don't come out anywhere near the top. Stable value funds have a very high disclosure, and although you lack some control, you don't have the same sort of drift with stable value and you have that growth." (Recordkeeping/full-service provider)

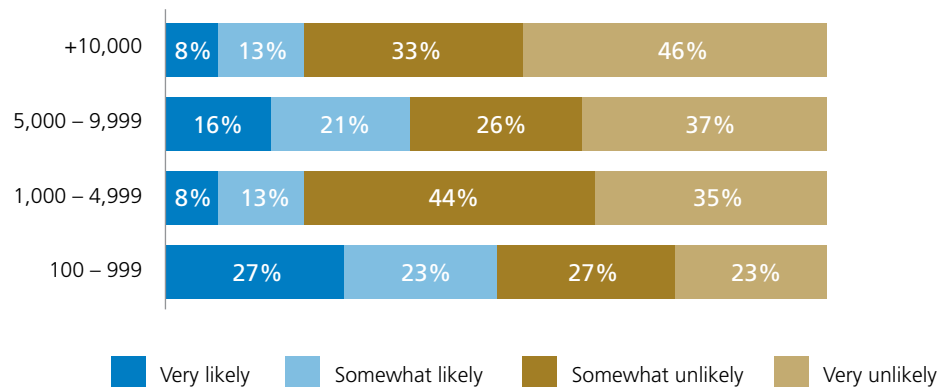
"Plan sponsors want to choose the most conservative option and will feel less liable when doing so. Choosing an equity fund or one of the target funds might bring in more risk. I would recommend stable value funds

and ask clients to educate their participants to actively manage their 401(k) funds. Nobody is going to make money leaving it in stable value." (Recordkeeping/full-service provider)

"Plans that have already established their QDIA option don't see a need to change. My own recommendation would differ by plan. If it were a union group with employees not generally financially astute or experienced, then I think a stable value fund would be the right QDIA. But if we're talking about a financial firm where employees are generally financially sophisticated, then a target date option would be OK." (Investment-only stable value manager)

Half of small plans say they would be likely to use stable value as their QDIA. It's interesting to note that, even among mega plans where auto enrollment and QDIA selection are already overwhelmingly in place, 21% still say they would be likely to use stable value as their QDIA.

Likelihood of Using Stable Value as a QDIA Option, If It Were Approved, by Plan Size
 (All Plan Sponsors, N=145)



Conclusion

While stable value has undeniably come into its own as a distinct asset class, the long period of market growth and resulting long period of stability of stable value behavior that preceded the market crash served to lull many sponsors, stable value fund providers and book value wrap providers into a sense of complacency about their stable value offerings. As one consultant commented:

“When stable value funds are producing steady returns, and the markets are fine, there’s no upheaval...when markets have been good there are so many other things on the front burner, that it’s traditionally been hard to have fiduciaries focus on features of these funds and how those features can make a real difference in different markets.”

At the same time, the separation of roles and responsibilities that has become commonplace along with stable value’s expansion as an asset class has inadvertently contributed to gaps in understanding among plan sponsors about how their stable value offerings actually work. The economic events triggered a reminder for all practitioners—plan sponsors, their advisors, stable value fund providers, and book value wrap providers—that stable value is a sophisticated structure, designed specifically around the unique characteristics of qualified defined contribution plans, in which book value guarantees, investment strategies, contract features and plan design all need to be properly balanced and integrated.

Notwithstanding the extraordinary “stress test” that the economic events have effectively posed for stable value generally, it’s important to acknowledge that stable value has come through all of this economic turmoil in remarkable shape, and have essentially done what they were designed to do well. That said, these same events have served as a reminder about the importance of sound design and of understanding how stable value fund features work under stress.

The study provides a road map for stable value practitioners and plan sponsors to follow as they examine their current stable value offerings with an eye towards strengthening this core investment option to ensure that stable value continues to work as designed in the future for plan participants.

Implications for Plan Sponsors

First, it's important that sponsors not lose sight that stable value options offer consistent, predictable growth over the long term, at very low risk to participants when well designed.

The key to a well-designed program is understanding. With this in mind, we offer the following considerations for plan sponsors.

> **Understanding stable value fund construction is fundamental.**

As the market upheavals have clearly illustrated, stable value is designed to smooth the volatility that results from market value changes, but is not immune from them. The range of investment strategies that underlies your stable value fund and the wrap guarantee provisions don't operate independently of one another, and are as important in many cases as the credit rating of the book value guarantee provider.

> **Know who your stable value fund's book value guarantee providers are.** The study suggests that in many cases, the sponsor may not be aware of who the book value guarantee providers associated with its stable value program are. Even if you access your stable value fund through an intermediary or service provider, be aware who they have retained as the stable value fund's wrap providers. The selection of a stable value offering, as with any investment option, is a fiduciary decision, regardless of how it is accessed.

> **A practical understanding of guarantee contract provisions is critical.** While all book value guarantees have to meet minimum standards to qualify for book value accounting, not all guarantees are constructed in the same way, and may vary with the type of investment strategy for which the book value guarantee is being provided, the type of firm providing the wrap contract, and the mix of features included. Most contingencies in a contract are not expected to actually occur, but are there for when the unexpected occurs. Understanding how each of your guarantee providers' contracts work in a range of possible business circumstances is the key to having a well understood and effective program.

> **Discuss in advance what employer-initiated events are and how each works, for each book value guarantee provider in your plan.** A fundamental requirement of all book value guarantees is a book value protection for participant directed account activities, and as a result, all book value guarantees draw a distinction between these normal course of business activities and employer-initiated events. The study makes it clear both that what is included as "employer-initiated events" varies significantly among providers and contracts, and that many plan sponsors are not familiar with those differences. A major employer-initiated event may never happen to your plan, but it makes sense to prepare for the unexpected, and to understand how various events that may occur in your firm's business could affect your stable value offering.

> **Assess if book value guarantees are considered a core business and competency for each of your wrap providers.** Providing book value guarantees involves risk. One thing plan sponsors can do is to include the experience of a potential book value guarantee provider as part of the due diligence process. If the guarantee provider has experience in providing guarantees through both good markets and troubled ones, it will be better positioned to work with your plan to address future market events.

> **Don't assume your stable value fund provider considers itself a fiduciary to your plan.** One of the most interesting study findings was that not all of those involved in stable value offerings consider themselves fiduciaries to the plans they serve. We would recommend that all plan sponsors take the time to understand how all of the parties involved, directly and indirectly, with stable value offerings see their roles, just as with any other qualified plan offering.

> **Transparency is becoming much more important.** Firms are entering an era of increased transparency on many fronts, and defined contribution plans—and their investment options—are no exception. Plan sponsors should ask for and expect reasonable transparency from their stable value fund providers, so that they are clear on the offering's structure, the providers involved, the roles each provider plays in supporting the offering, investment strategies and guarantee features and provisions.

Methodology

In order to gain greater insight into the changing landscape of stable value wrap products by understanding the perspectives of both stable value fund plan providers and plan sponsors, MetLife engaged the services of Mathew Greenwald & Associates and Asset International, Inc., publishers of *PLANSPONSOR* and *PLANADVISER* magazines. Two separate studies were conducted—phone interviews with stable value fund plan providers and an online survey of plan sponsors. The two research initiatives addressed many of the same important stable value topics and issues.

Among the topics addressed in these research studies are the perceived value of various book value guarantee features, the prevalence of various provisions in the current marketplace, the nature and degree of plan sponsor communication and disclosure practices about contract features in ongoing plans, and the criteria they use to select stable value fund providers and book value guarantee providers. The plan sponsor study also gauged defined contribution plan sponsors' awareness of stable value fund structures and the relationships they have with their stable value fund providers. Both survey instruments were developed by staff at MetLife in collaboration with Mathew Greenwald & Associates and Asset International, Inc. Note that for some questions, both stable value fund providers and plan sponsors using more than one book value guarantee provider could give multiple, provider-specific responses.

ONLINE SURVEY WITH PLAN SPONSORS:

Asset International provided the sample of plan sponsors, and deployed the e-mails and reminders to the sample containing a link to the online survey. A total of 145 online interviews were completed. To be eligible for the study, participants needed to work for companies with 100 or more participants in 401(k) or 457 plans that offered stable value options. They had to have at least a moderate amount of influence over decisions regarding stable value or related funds. All survey responses were received between November 2nd and December 17th, 2009.

PHONE INTERVIEWS WITH STABLE VALUE FUND PROVIDERS AND CONSULTANTS:

MetLife provided the sample universe of stable value plan providers and consultants from which Mathew Greenwald & Associates qualified respondents. A total of 13 interviews were conducted by senior researchers at Mathew Greenwald & Associates with people in those organizations who have considerable influence in determining the nature and type of relationships their company has with book value guarantee providers. Stable value fund providers working with DC plans averaging fewer than 100 participants were excluded.

Of the 13 stable value providers interviewed, five are recordkeeping/full-service providers, four are investment-only stable value managers, three are TPAs and one is a QPAM. All interviews were conducted during November 3–25, 2009 and averaged about 30 minutes in length.

Plan Sponsor Profile

Number of DC Plan Participants	Percent of Plan Sponsors
10,000 and more	33%
5,000–9,999	13%
1,000–4,999	33%
10–999	21%

DC Plan Assets	Percent of Plan Sponsors
More than \$1 billion	27%
\$250 million–\$1 billion	16%
\$50 million–\$249 million	27%
Less than \$50 million	19%

Stable Value: A Primer

Stable value is a core element in the fabric of the U.S. defined contribution system. Even since the turbulent economic environment worsened beginning in late 2007, stable value has continued to offer a safe haven for plan participants. One survey reported that while overall participant 401(k) balances declined by 27.5% in 2008,⁹ the return on an average stable value fund was a positive 4.7%.¹⁰ A look at how stable value has evolved is very helpful in understanding what is “under the hood” of today’s stable value asset class.

Stable value is an investment option designed to offer plan participants the greatest total return consistent with protection of principal. Stable value is designed to enable participants to make transactions such as transfers to another plan option at “book” value regardless of the market value of the underlying assets. Book value—also called contract value—means the contributions made, plus accrued interest, minus previous withdrawals or transfers. Participants’ ability to transact at book value is called “benefit responsiveness,” and is a characteristic shared by all stable value products. Underlying market value fluctuates daily with investment markets, and net investment gains and losses are recognized over a period of years in the credited rate at which participants transact under the book value guarantee. By definition, the market and book values are not the same, but the stable value mechanism is designed to always bring them back to convergence over the period specified in the credited rate formula.

The first generation of modern stable value products was introduced some 30 years ago in the late 1970’s. The insurance company guaranteed interest contracts (GICs) that emerged from earlier “portfolio rate” products remain a mainstay of stable value today. They are easily understood by plan sponsors and participants, featuring an interest rate guaranteed in advance, guaranteed principal, a specified maturity date and the ability of plan participants to make allocations to and from the funds at book value. These general account or “traditional” GICs are issued and guaranteed by insurance companies and backed by the insurer’s general account. This type of stable value product includes a direct and explicit guarantee of principal and interest credited to the plan, provided the contract is held to its predefined maturity date.

Twenty years ago, MetLife pioneered a variation of the traditional GIC known as a “Separate Account GIC” (SA GIC). The SA GIC offers a guarantee supported by one or more fixed income separate accounts instead of the general account. This innovation enabled plans to credit higher rates to plan participants with funds invested in fixed income strategies not limited by regulatory constraints that affect general account assets, and later on, addressed concerns of some plan sponsors such as transparency of the assets supporting the arrangement and potential future insurer credit risk. With SA GICs, crediting rates are reset periodically and market value gains and losses of the underlying

⁹ *Fidelity Perspectives: An Unprecedented Year*, Fidelity Investments, <http://dcda.fidelity.com/public/content/WPS/pages/MarketVolatility>.

¹⁰ Hueler Analytics Stable Value Pooled Fund Index.

portfolio are smoothed over a period of years, typically the duration of the investment portfolio. SA GICs generally provide the plan sponsor with an option to convert to a fixed guarantee. In the event that a sponsor wishes to change providers, this type of product also often provides a wind down mechanism to preserve book value as an alternative to an immediate market value transfer. The SA GIC joined the traditional GIC as a fixture in the stable value marketplace.

The most recent product iteration to emerge was the synthetic GIC, also called a Trust GIC. While synthetic GIC structures vary, all synthetics differ from insured GICs in two important ways. First, the stable value plan investments are held directly by the qualified plan trust. Second, the manager of the assets has to obtain a book value guarantee from another financial institution that will enable plan participants to transact at book value, which would not otherwise be possible. These agreements, called “wrap” contracts, impose limitations on how the funds under the book value guarantee can be invested. This type of stable value product typically provides a guarantee that the plan participant can transact at book value, so long as the wrap contract remains in effect.

Wrap contracts are provided by insurance companies, banks and other financial institutions. Accounting guidance provided in SOP 94-4-1 in 1994 enabled financial service institutions other than insurance companies to enter the stable value market (e.g., with bank investment contracts), but it was the decoupling of asset management from the book value guarantee related to the assets that led non-insurers to enter and come to dominate the so-called “wrap” market. This development significantly reconfigured the market with respect to providers, roles and guarantee provisions, and laid the groundwork for the stable value options plan sponsors have today.



MetLife

Metropolitan Life Insurance Company
200 Park Avenue, New York, NY 10166
www.metlife.com

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