Stable Value Fees & Performance – Going Down the Investment Rabbit Hole

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Stable value investment products (also known as stable value funds), unlike mutual funds, do not have a single, consistent method of reporting fees and performance. That's not necessarily a good or bad thing. Mutual funds, being products that are registered with the Securities and Exchange Commission, simply have higher levels of disclosure requirements and as a result, conformity. The challenge with level setting the landscape of stable value fund fee and performance reporting may be partially explained by the existence of various stable value fund structures. The three basic structures are: synthetic GICs that wrap a Collective Investment Trust (the "CIT Structure"), separate account GICs (the "Separate Account Structure"), and general account GICs (the "General Account Structure"). Additionally, different stable value fund providers may have varying approaches and philosophies regarding how they calculate their performance and disclose their fees. Each approach to disclosing fees and calculating performance may be valid, but the differences support an environment where an easy "apples to apples" comparison cannot be made. In other words, the comparison of two (or more) stable value funds may involve vastly different definitions of fees and calculation methods for performance.

The goal here is to provide a backdrop of the reporting and disclosure requirements, present a context on how to navigate the comparison of fees and performance within the different structures, introduce meaningful questions to ask providers and provide advisors a better understanding of the evaluation of fees and performance within the stable value marketplace.

Background

Performance evaluation is and has always been important within any asset class. Over the last decade, there has been a growing emphasis on identifying fees and developing a framework to disclose fees to retirement plans. In 2012, plan disclosure rules were passed by Congress and enacted into law.[1] These regulations require providers to disclose fully explicit fees paid by plan participants and to provide an annual disclosure highlighting investment fees. In addition, the regulations require service providers to supply plan sponsors with a services agreement that includes full disclosure of all fees. The intention of these rules is to reduce the information gap between plans sponsors, services providers and plan participants; ultimately, the goal of both sets of disclosures is for plan participants and plan sponsors to gain greater transparency regarding the fees associated with their plans.

Both required disclosures include information on fees within the investments themselves. While there are variations and distinctions across different investment fund structures, accounts and types of funds for reporting fees, the focus of this discussion will be on the fees and performance specific to stable value funds.

Very often fee disclosure requirements are the "go to" items when discussing the topic of fees in the retirement industry. It is important to note that because there are nuances within the required disclosures that are geared toward mutual funds, some fees may not always be easy to identify because there may be varied interpretations for other investment classes such as stable value. However, there are tools that can help build a clearer overall picture in terms of fees and performance. The use of fact sheets, product books, pitch books, web sites, fund provider contracts and third-party materials can sometimes fill in the missing pieces of the puzzle; but sometimes they are not available or if they are available, they may not always be fully transparent.

Although the mandatory disclosures have brought with them a higher level of standardization to the marketplace, it is very likely that there may still be some digging needed in order to effectively evaluate and monitor the fees and performance of stable value funds. That is the good news. If you happen to be working with a new client or on a new search, the process of gathering fee and performance information for the candidate stable value funds can be daunting.

Summary of the fee disclosure regulations:

1 – Reasonable Contract or Arrangement Under the Employee Retirement Income Security Act of 1974 Section 408(b)(2) – Plan Level Fee Disclosure

Imposes a fiduciary obligation on plan service providers to disclose to plan sponsors the administrative and investment costs associated with their plans. This also includes a description of the services provided and all direct and indirect compensation. These fees are not seen by nor are they required to be provided to the participants in the plan.

2 – Participant Level Fee Disclosures Under the ERISA Section 404(a)(5) – Participant Level Fee Disclosure

Imposes a fiduciary obligation on plan administrators to provide plan participants detailed information about their plan's investment options and fees, as well as expenses paid by participants and the plan for the investment of their accounts and administration of the plan.

Structures, Fees & Performance – One Size Does Not Fit All

Stable value funds have a myriad of fees associated with them and the most common ones are as follows: Investment Management Fees, Wrap Fees, Operating Fees, Acquired Fund Expenses, Fee Offsets, Revenue Sharing, Contract Fees, Trustee Fees, Administrator Fees and Recordkeeping Distribution Fees. When evaluating fees, it's prudent to first identify the structure of the fund, and the fees commonly associated with that structure in order to effectively classify and compare. No structure is inherently better or worse than another and the determinant of the most appropriate structure for a client should be selected after a thorough investigation of the plan's profile, needs, and priorities.

Its critical to not only identify the applicable fees within a given structure, but also when, and if, each of those fees are reflected in the performance. In other words, what is the performance representing? Is it net performance after fees? Is it gross performance before fees? Net performance after some fees are applied, but not others? This is where the proverbial water begins to get murky.

The CIT Structure typically has the greatest assortment of fees associated with it, and this structure tends to, generally, have a higher level of fees. This is not necessarily a negative, but it can be confusing. Typically, the fees associated with the CIT Structure are an Investment Management Fee, a Wrap Fee, a Distribution Fee and a Trustee/Administrator Fee. Keep in mind that sometimes different providers use different names for fees and some fees are disclosed separately in granular detail, while others might be bundled together.

Usually, the CIT Structure tends to be a bit more transparent than Separate Account and General Account Structures. This is because CITs are established by banks and trust companies, so the reporting and regulatory requirements are typically more detailed. As a result, its usually easier to find salient information that leads to additional details and disclosures.

In terms of performance for the CIT structure, it is typically a product of the underlying portfolio's investment return, with no rate or return guarantees. Note: check the fine print and ask if the illustrated performance reflects all the fees that exist in the fund.

Separate Account and General Account Structures are issued by insurance companies and are insurance products. An insurance company's General Account is intended to support the company's outstanding liabilities. The assets held in the General Account are wholly owned by the insurance company and are reflected on its balance sheet. From a legal perspective, the assets are commingled and not earmarked or attributed to any individual plan, liability or policyholder. The crediting rate is established in advance, and can reset quarterly, semi-annually or annually. The insurance company bears the full risk of the guarantee when determining the declared crediting rate. Very often it is difficult to discover a detailed expense ratio or fees on this structure. Furthermore, there are times when explicit expense ratios may not be disclosed by the product provider at all.

Separate account assets are segregated from the insurance company's general account and its creditors. The assets are also owned and managed by the insurance company or an affiliate but are held in a separate account that can be insulated from the general account's liabilities. The associated fees for investment management, wrap coverage and/or distribution are most common, but are sometimes hard to obtain or decipher. Contract providers may also impose additional charges on top of the aforementioned fees. In order to implement an effective due diligence process, all associated fees must be discovered.

Additionally, in order to create a consistent analysis and "apples to apples" comparison, the following questions need to be asked:

1. What is the full accounting of all the fees for the stable value fund?
2. Is a full accounting of all fees available on an ongoing and consistent basis?
3. Can the fees change? If so, how often?
4. What is the historical and current performance of the fund?
5. Is the performance data actual, composite or hypothetical?
6. If the data reflects composite or hypothetical performance data, can the actual performance be obtained?
7. Are all fees accounted for in the net performance data?
8. If all fees are not included, which fees are excluded?
9. Is the performance available on an ongoing and consistent basis?
10. How often will the performance data be updated and released?
11. Are the wrap contract/agreements available for review?

Transparency is critical to obtaining the answer to these questions and the key to a solid foundation for a prudent and consistent process.

Remember that fees and performance are not the only factors that need to be analyzed during the evaluation and monitoring process. The financial strength of the provider, as well as their reputation and history should also be examined. Additionally, the fund's discontinuance provisions, the guarantees offered, the history and track record of the investment manager, are all also fundamental to a thorough, proper review. Of course, the information obtained must be available, current, accurate, applicable, and relatively easy to decipher.

Consider seeking the advice of a professional so that you don't dig the rabbit hole that is the world of fees and performance of stable value funds by yourself!

Ready to discuss stable value options with your clients in more detail? Contact your New York Life representative or visit us at stablevalueinvestments.com.

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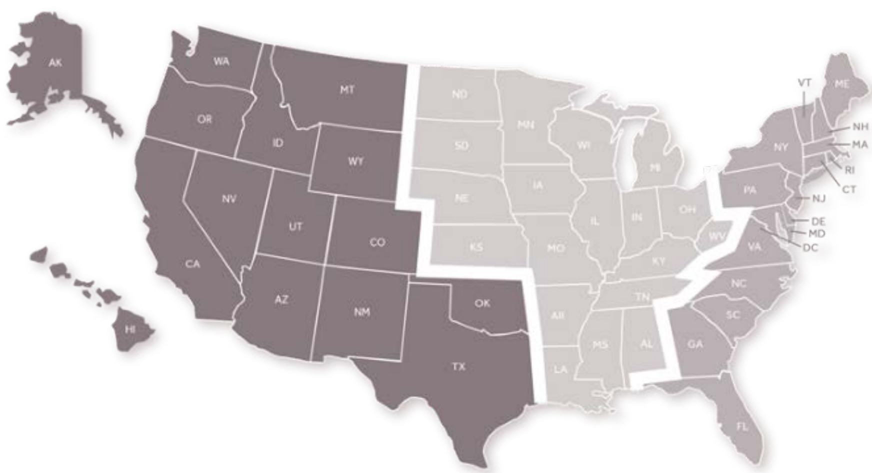

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[1]Employee Retirement Income Security Act of 1974 Section 408(b)(2), for fee disclosures from service providers to plan sponsors, and Section 404(a)(5), for participant-level fee disclosures.

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