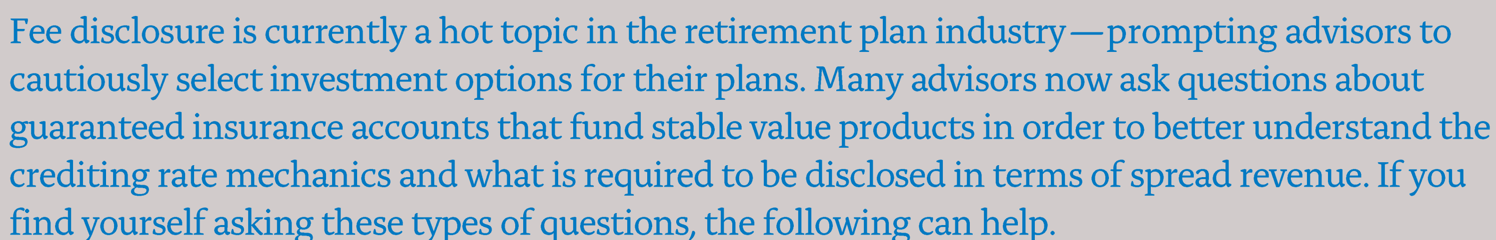
New York Life Stable Value Investments

Understanding Spread



Fee disclosure is currently a hot topic in the retirement plan industry—prompting advisors to cautiously select investment options for their plans. Many advisors now ask questions about guaranteed insurance accounts that fund stable value products in order to better understand the crediting rate mechanics and what is required to be disclosed in terms of spread revenue. If you find yourself asking these types of questions, the following can help.

What is the crediting rate in a guaranteed insurance account?

The crediting rate in a guaranteed insurance account product refers to the interest credited to participant accounts; and it is declared and guaranteed in the first contract year, in advance for up to one year and thereafter, in advance, for six months. Generally, the guaranteed insurance account guarantees a minimum rate of return ranging from 1%–3% regardless of the performance of general account assets.[1] It is common for guaranteed insurance accounts to have a higher crediting rate than other stable value products because the underlying assets typically have a longer duration than, for example, the assets held in a money market fund. Simply put, crediting rate is the rate of return that a participant will receive on contributions and accrued interest, and should be an important part of any sponsor's evaluation before adding a guaranteed insurance account product to a plan's investment lineup.

What is spread?

An insurance company is required to reserve capital to support the declared and guaranteed crediting rate on the guaranteed insurance accounts it offers. Spread revenue — or "spread" — refers to the difference between the actual earnings on investments made by the insurer and the crediting rate guaranteed to participants for that period. The crediting rate is subject to the minimum guaranteed rate stated in the insurance contract. Unlike fee products, spread is not pre-fixed or predictable. While the stated rate of return to plan participants is guaranteed, fluctuating investment returns, asset impairments, higher capital requirements, or other adverse situations may result in actual returns that are below the stated guaranteed rate. So, it is important to understand that spread does not always translate into profit for the insurer — it can just as easily translate into loss.

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Must spread be disclosed under the Department of Labor (DOL) fee disclosure rules?

No. The DOL excluded guaranteed insurance account contracts and other fixed return investments from fee disclosure requirements, stating that these products must "provide a fixed or stated rate of return to the participant for a stated duration."[2] Guaranteed insurance account contracts are managed collectively in the insurer's general account and are not earmarked for a specific liability. This differs from other stable value products that have a stated fee, usually expressed as a percentage of account value and deducted from the investment return.

Is it important to compare spreads across insurance companies?

Guaranteed insurance accounts are designed to deliver an insurance guarantee of principal and a declared interest rate, a concept similar to that of other fixed deferred annuities or certificates of deposit from a bank. Assume two providers with similar strong credit ratings both offer a guaranteed insurance account. Provider A guarantees a 4% rate but does not disclose spread, while Provider B offers a 2% rate and discloses some component of spread. In this example, it is easy to see that spread earned by the insurance company is not relevant and your focus should be on which product would better serve the investor.

Attempting to compare spreads across providers may lead to inaccurate conclusions because the factors compared may not be equivalent. Reserve requirements (such as the Risk Based Capital method of the National Association of Insurance Commissioners) vary by company and often by the organization's financial strength and ratings. Reserve requirements dictate the types of assets an insurer may hold in its general account portfolios and expected investment yields. As noted above, unlike fixed fees found in mutual fund structures, the determination of spread in a guaranteed insurance account structure is variable and unpredictable. Each insurer has a different portfolio mix, distinct contract terms, and capital requirements, any of which may cause spread earnings to vary — making comparisons not only difficult, but ultimately meaningless.

What should I compare when reviewing guaranteed insurance accounts?

It is important to understand the guarantees being promised to you by the insurer — including the participant's crediting rate. You should ensure that the terms of the contract are consistent and not misleading. Then you should focus on the safety and creditworthiness of the insurer behind the guarantees, as opposed to any spread that the insurer may or may not earn. Begin by reviewing an insurer's credit ratings from the major rating agencies; then consider the quality and diversification of the insurer's investment portfolio, the insurer's business lines and exposure to liabilities, the level of the insurer's capital and surplus, and any major negative headlines. Review the structure of the insurer's contracts and the guarantees. Finally, feel comfortable requesting a meeting with an insurer's product and investment teams to help better understand their operations.

When selecting a guaranteed insurance account product, you are offering your participants a guaranteed return backed by the full faith and credit of the insurer. Backed by the general account, these products can offer many advantages over other stable value products including access to different investing strategies, longer durations, and potentially higher yields. As a fiduciary you can rest assured you are meeting any fee disclosure requirements and offering the most competitive products in your plan.

To learn more about spread or general account products, please visit us at stablevalueinvestments.com or contact your New York Life representative.

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[1]Based on applicable state law or the NAIC model Standard Nonforfeiture Law for Individual Deferred Annuities.

[2]Federal Register vol. 75, No. 202, Wednesday, October 20, 2010. Department of Labor Employee Benefits Security Administration, 29 CFR Part 2550 "Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans."

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