Dating back to the inception of defined contributions plans in the 1970s, many stable value funds have utilized Guaranteed Investment Contracts (GICs) as a critical element in their portfolios. GICs have a similar structure to bank certificates of deposit but, instead, are issued by insurance companies. While GICs are not FDIC-insured, they offer a guaranteed rate of return in exchange for holding a deposit for a period of time — typically two to five years. This guarantee is backed by the claims-paying ability of the issuing insurance company’s General Account. GICs usually do not have an explicit investment cost. However, fees are generally deducted to the extent of the amount guaranteed or are taken into account in pricing, based on a spread (for more information, please visit our website to read “Understanding Spread”).

While allocations to GICs in a stable value fund portfolio offer this guarantee feature, the incorporation of GICs also introduces a layer of complexity and insurance company risk that is not always visible to plan sponsor fiduciaries, who are obligated to invest prudently. Comparing different stable value structures — e.g., insurance company General Account, Separate Account, or Synthetic Stable Value Funds* can be both challenging and confusing, particularly if a stable value fund utilizes both spreads and fees within its portfolio. For instance, stable value funds typically exclude GICs from their expense ratio calculations. Additionally, stable value fund managers often assume GIC positions are held at par when calculating the market-to-book of the stable value fund itself, excluding the market-to-book ratio for the underlying insurance company’s General Account.

Insurance company risk describes the potential of the insurance company defaulting on their obligations. The insurance company’s General Account is subject to creditor liabilities and, therefore, insolvency risk to plan assets invested in GICs. In contrast, stable value assets invested in an insurance company’s Separate Account or in a Synthetic GIC* stable value fund structure are generally insulated from insurance companies’ General Account liabilities.
Whether a stable value fund utilizes GICs is not inherently good or bad; however, before investing in a stable value fund that holds GICs, it is crucial for plan sponsor fiduciaries to understand all mechanisms that are at work inside the fund — especially as they relate to fees, risk, and performance. For example, to the extent that there are any GIC holdings within a stable value fund, fiduciaries should request details on these holdings, such as:

1. **How much of the stable value fund is allocated to GICs?**
   - *The higher the percentage, the greater potential for insurance company risk.*

2. **Which insurance company(ies) issued the GICs?**
   - *Document and monitor the financial strength for each of the issuers.*

3. **What is the duration for the underlying GICs?**
   - *The longer the duration, the more sensitive to interest rate changes – particularly important in a rising interest rate environment.*

4. **How is the insurance companies’ General Account positioned?**
   - *Document and monitor the General Account(s)’ investment allocations.*

New York Life’s stable value consultants stand ready to assist with the due diligence process by providing the insurance company financial strength ratings from the four major rating agencies, as well as their COMDEX ranking.2

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1 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.

2 The Comdex ranking is a percentile score on a number scale from 1 to 100. It is a composite score averaging the ratings of the four major insurance rating agencies. The Comdex rankings are compiled by EbixLife.

*Definitions*

**Guaranteed Investment Contract (GIC):** Stable value investment contracts (typically a group annuity contract) issued by an insurance company that pays a specified rate of return for a specific period of time, offers book value accounting, typically pays benefits to plan participants, and provides annuities upon request. These contracts are also known as guaranteed interest contracts and may be backed by either an issuer’s General Account assets or Separate Account assets. In all cases, the insurance company owns the invested assets and the obligation to the contract-holder is backed by the full financial strength and credit of the issuer. A GIC that is held as an investment by a stable value investment option is typically known as a traditional GIC, while a GIC offered as the sole stable value investment option is more generally known as a guaranteed insurance account.

**Separate Account GIC:** A stable value investment contract that is first supported by associated assets in a segregated Separate Account held by the issuing insurance company and then, to the extent necessary, by the insurer’s General Account assets and surplus. The crediting rate on a Separate Account GIC resets periodically based upon the earnings of the Separate Account assets. The securities held in the Separate Account are owned by the insurance company but are held for the exclusive benefit of the plan or plans participating in the Separate Account. If the investment contract stipulates, in the event that the insurance company becomes insolvent, the Separate Account assets may not be used to satisfy any of the insurer’s other liabilities.

**Synthetic GIC:** A stable value investment structure that offers similar characteristics as a guaranteed investment contract, i.e., pays a specified rate of return for a specific period of time, is benefit-responsive, and offers book value accounting. A synthetic GIC includes an asset ownership component and a contractual component that is intended to be valued at book value. The associated assets backing the contract’s book value are owned and held in the name of the plan or the plan’s trustee. Such associated assets typically consist of a diversified fixed income portfolio, including but not limited to treasury, government, mortgage, and/or corporate securities of high average credit quality. To support the book value obligation, the contract-holder relies first on any associated assets and then, to the extent those assets are insufficient, the financial backing of the wrap issuer. Wrap contracts can be issued by banks, insurance companies, or other financial institutions.

Source: Stable Value Investment Association
Ready to discuss stable value options in more detail? Contact your New York Life and visit us at stablevalueinvestments.com

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