

A Prudent Fiduciary Process for Stable Value Investment Options

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Stable Value investments preserve capital and are invested in high quality, diversified fixed income portfolios that are protected against interest rate volatility by contracts from banks and insurance companies. Stable Value investments are considered conservative and low risk investments compared to other investments offered in 401(k) plans. (Stable Value Investment Association website, 2009)

Overview

Stable Value investments provide a unique challenge to fiduciaries. While they are intended to serve investors who have low risk tolerances, they still pose risks that fiduciaries need to understand and monitor, especially in times of economic uncertainty.

While Stable Value investments may appear to some as “risk free,” they clearly are not. When financial markets are under significant stress, it is likely that a Stable Value investment option is as well. While Securian has concerns with certain Stable Value investment types, it is ultimately the plan fiduciary’s responsibility to assess and monitor the risks of all the plan’s investment options.

Plan fiduciary evaluation of Stable Value investments starts with understanding the specific type your plan uses (see p.2) and continues with a careful review of its key characteristics to best evaluate potential risk to the plan’s participants.

This paper presents information that plan fiduciaries should consider when evaluating the three types of Stable Value investment options. It outlines the risks of each and the information that should be requested when working with a provider. It was prepared to help plan sponsors understand their fiduciary obligations and the possible pitfalls and risks of Stable Value investments to ensure the interests of plan participants are protected.

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I. Investment-Related Fiduciary Duties for Retirement Plan Investment Options

Fiduciary duties concerning qualified retirement plan investments under the Employee Retirement Income Security Act of 1974 (ERISA) are governed by the “Prudent Man Standard of Care.” Two key elements of this standard require fiduciaries to:

1. Act solely in the interest of plan participants; and
2. Have a “prudent process” that involves careful investment option monitoring to ensure the interests of participants are protected.

All investment options offered under a retirement plan should be in the best interests of plan participants when initially selected and at all points thereafter.

Most investment options are marked to market on a daily basis. Participants are exposed to daily market risk and incur gains and losses as the securities within the investment option change in value. The market risks of these investment options are reasonably transparent to participants.

This is not the case with Stable Value investments which are designed to preserve capital while providing steady, positive returns. Because steady returns may imply little or no risk, it is imperative that plan fiduciaries thoroughly understand Stable Value investments. In some ways, they have a higher degree of responsibility with these investments because the risks are not as obvious to participants.

II. The Three Types of Stable Value Investments

There are different ways to structure Stable Value investments. The Stable Value Investment Association (SVIA) defines three types:

Type 1 - Insurance Company General Account Stable Value

“A contract with an insurance company that provides principal preservation and a specified rate of return over a set period of time, regardless of the performance of the underlying invested assets. The invested assets are owned by the insurance company and held within the insurer’s general account.”

Type 2 - Insurance Company Separate Account Stable Value

“An account held by an insurance company that holds a combination of fixed income securities and provides principal preservation and a specified rate of return over a set period of time. Separate accounts may provide either a fixed rate of return or a periodic rate of return based on the performance of the underlying assets. The assets are owned by the insurance company and are set aside in a separate account solely for the benefit of the specific contract holder.”

Type 3 - Wrap Guaranteed Stable Value

“A diversified portfolio of fixed income securities that are insulated from interest rate volatility by contracts (wraps) from banks and insurance companies. In this arrangement, the 401(k) plan and its participants own the underlying invested assets – the portfolio of fixed income securities that support the Stable Value fund.”

It is imperative that plan fiduciaries thoroughly understand Stable Value investment options. In some ways, they have a higher degree of responsibility with these investments because the risks are not as obvious to participants.

III. Stable Value Investment Risks

Each Stable Value investment type has different risks and methods for guaranteeing principal and investment returns. Plan fiduciaries should know that the risk of a Stable Value investment option is a combination of:

- A. The risks of the underlying investments;
- B. The contractual provisions concerning the investment option and its guarantees; and
- C. The financial soundness of the entity backing the guarantee.

Another distinguishing feature is whether the investment is a separately managed account for a single retirement plan or a commingled account across a multitude of (often smaller) retirement plans. While a commingled account provides more scale, it exposes a retirement plan to risks associated with the experience of the other plans.

Another distinguishing feature of a Stable Value investment is whether the investment is a separately managed account for a single retirement plan or a commingled account across a multitude of (often smaller) retirement plans. While a commingled account provides more scale, it exposes a retirement plan to risks associated with the experience of the other plans.

A. Risks of Underlying Investments

With all three Stable Value investment types, the assets are primarily invested in a diversified portfolio of debt securities, ranging from government and corporate bonds to consumer and commercial mortgage securities. These securities are subject to a variety of market risks including:

- **Interest rate risk**
 - The value of the securities varies inversely with changes in interest rates. Increasing interest rates decreases the value of debt securities.
- **Credit risk**
 - As the market perception of potential issuer default increases, the value of the debt security decreases. If an issuer defaults, the investment may return significantly less than the original investment.
- **Liquidity risk**
 - The market may become less liquid or illiquid during times of economic stress.

The market value of the underlying investments can go down significantly due to one or a combination of these risks. For this reason, it is important for fiduciaries to regularly assess the market risks that pertain to their Stable Value investment option.

Under **Type 1 – Insurance Company General Account Stable Value** – the market value of the entire insurance company’s assets must exceed the total of all liabilities of the insurance company. This is called “excess capital.” State statutory regulations require insurance companies to hold a minimum amount of required excess capital. In general, insurance companies are regulated in this regard at the state level, depending on where they are domiciled. State regulations can and do vary. The minimum amount of capital is determined specifically to each insurance company based on the risks of the products it offers and is defined as “risk-based capital.” **The concepts of risk-based capital and regulatory actions are discussed in Appendix A.**

An insurance company's overall risk can be identified by the ratio of the Total Adjusted Capital to the minimum risk-based capital. When the economy is experiencing stress, this ratio will trend downward. Annual updates of this ratio are appropriate under normal conditions. Each year, insurance companies are required to publish and file the information used to compile this ratio in their "Blue Books."

Practical Action 📌 Retirement plan fiduciaries may want to ask for more frequent updates of the ratio of the total adjusted capital to the minimum risk-based capital during economic turmoil. However, it is important to remember that such updates will not be based on year-end and may include significant variations based on state regulations. In general, the fiduciary will want to be sure the ratio continues to be in excess of the 200% of minimum risk-based capital.

Fiduciaries should regularly assess the market risks as they pertain to their Stable Value investment option ... While annual updates are appropriate under normal conditions, retirement plan fiduciaries may want to ask for more frequent updates during economic turmoil.

Another more traditional method of assessing an insurance company is by the financial strength and claims-paying ratings assigned by independent ratings agencies. Four of the more widely known companies that issue ratings are: A.M. Best, Standard & Poors, Moody's, and Fitch. While definitions on the respective ratings can be obtained from each of their web sites, most of these services use a letter-based rating structure where A and above are considered secure, strong companies. The web site addresses are shown here for your convenience.

- A.M. Best - www.ambest.com
- Standard & Poors - www.standardandpoors.com
- Moody's - www.moodys.com
- Fitch - www.fitchratings.com

Under Type 2 – Insurance Company Separate Account Stable Value and Type 3 – Wrap Guaranteed Stable Value – the market value will typically differ from the total account values, either positively or negatively. In these options, the ratio of the market value of assets to the total account values of the retirement plan investors is an important measure of risk. As the ratio decreases below 100%, the investors' risk increases.

Practical Action 📌 The retirement plan fiduciary should request the ratio of market value to total account values at least annually and more frequently when the ratio is below 100% and/or trending downward.

As the crediting rate is typically based on a formula that includes the relationship of the market value of assets to the total account values, an unusually large decrease in the crediting rate of the Stable Value fund is often a sign that the ratio of market value to total account values has declined substantially and that the Stable Value fund is experiencing notable stress.

B. Stable Value Investment Option Contract Provisions

The Stable Value investment option provisions are typically defined in a legal document, such as a group annuity contract or an “Offering Memorandum.” The retirement plan fiduciary should understand these provisions to ensure that the participants’ interests are protected.

Typical provisions include:

- Frequency of Crediting Rate Resets
 - More frequent changes are a risk mitigator
 - A change to more frequent changes may be a signal that the investment option is under stress.
- Participant Investment Transfer Provisions, including:
 - Any limitations on the amount and/or frequency of transfers between the Stable Value option and the plan’s other investment options.
 - The definition of “Competing Investment Options” and restrictions concerning these investments.
 - › Stable Value investment options typically restrict transfers to fixed income options that may be viewed by participants as low risk.
- Participant Withdrawal Provisions
 - Defined withdrawals that are “benefit responsive” at the participant’s account value.
 - Timing of payments and rights of Stable Value provider to delay
- “Withdrawals Initiated by Plan Sponsor” Provisions
 - These are typically not available immediately at full account value or are paid out at a market value that may be less than the account value.
 - Some participant-directed withdrawals may be defined as “Withdrawals Initiated by Plan Sponsor” under certain conditions.
- Termination provisions that allow the Stable Value provider to terminate the Stable Value investment option and pay out the proceeds at market value.

A Stable Value investment option is not a money market investment. It invests in a portfolio of fixed income securities with a longer portfolio duration, typically 2 to 3 years. It is imperative for the Stable Value manager to restrict transfers and withdrawals to maintain an acceptable level of risk for Stable Value investors.

A Stable Value investment option is not a money market investment. In fact, because a Stable Value Investment option provides principal and interest rate guarantees, it is unlike investment options where such risks are borne by the participant. A Stable Value investment invests in a portfolio of fixed income securities with a longer portfolio duration, typically 2 years or longer. It is imperative for the Stable Value manager to restrict transfers and withdrawals to maintain an acceptable level of risk for Stable Value investors. Insurance companies must protect the contractual and policy benefit interests of all policyholders, while Stable Value providers must protect the interests of other investors in the Stable Value investment and the wrap guarantee providers.


C. Fiduciary Evaluation of Guarantee Source(s)

Stable Value investment options are either backed by the claims-paying ability of an insurance company (Types 1 and 2), or by “wrap providers” hired by the Stable Value portfolio manager (Type 3). Wrap providers are typically a collection of banks or insurance companies that receive a fee to guarantee the benefit responsive payments for participant withdrawals and book value accounting treatment for retirement plans.

The entity or entities providing the book value guarantees should always be identified. The financial soundness of these entities should be evaluated by:

- ratings provided by reputable rating agencies;
- published financial statements; and
- their excess capital relative to capital requirements.

In times of economic stress, Stable Value investment managers may find it difficult to establish additional capacity with entities that offer wrap agreements. This will naturally lead to increased charges for wrap agreement protection. Increased wrap charges will directly decrease the already depressed returns of the Stable Value investment option.

Practical Action  for Type 3 (Wrap Guaranteed Stable Value). Since the wrap providers may change occasionally, plan fiduciaries should ask for frequent updates. These updates should include:


- any changes in the cost to the investment option of providing these wrap agreements,
- any changes in the capacity (limits on the amount of book value guaranteed) by each of the wrap providers, and
- any changes to the crediting formula or other provisions of the Stable Value investment option since the last inquiry.

In times of economic stress, Stable Value investment managers may find it difficult to establish additional capacity with entities that offer wrap agreements. This will naturally lead to increased charges for wrap agreement protection. Increased wrap charges will directly decrease the already depressed returns of the Stable Value investment option. In addition, wrap providers will employ other risk mitigation actions. These risk mitigation techniques may include:

- shortened amortization periods for crediting rate setting;
- shortened portfolio duration and increased investment in cash instruments;
- increased limitations on competing investment options; and
- more stringent requirements to be considered a participant withdrawal (rather than a withdrawal initiated by the plan sponsor).

IV. Suggested Fiduciary Considerations for Stable Value Investment Options

Securian has prepared a “Suggested List of Fiduciary Considerations” for each Stable Value investment type. These are provided in Appendix B and Appendix C.

Practical Action  In assessing the risks and returns of the Stable Value investments, plan fiduciaries should collect information that directly applies to the investment risks at least annually.

This information should be carefully evaluated and any additional points needing clarification should be addressed with the Stable Value investment provider.

Securian is proud of the competitive interest crediting rates of its general account Stable Value options. When fairly benchmarked against the universe of Stable Value investment options, Securian’s option has provided competitive returns, particularly in light of the liquidity provisions and risks associated with Stable Value investments.

V. Securian’s Perspective on Stable Value Investment Options

A. “Single Credit” Risk of Type 1 Stable Value Investments

Critics of Insurance Company General Account Stable Value investments (Type I) typically are concerned with the “single credit” risk (i.e., the risk that the insurance company is the sole guarantor). Securian understands this concern and agrees that plan fiduciaries must pay attention to it.

At Securian, we respond to this concern by understanding our obligations, and honoring our commitment to fulfill them through all economic environments. As of the date of the publication, our excess capital position continues to be one of the strongest in the industry. Also, since Securian is not a publicly traded insurance company, we do not pay dividends to shareholders. We have the ability to retain our earnings as excess capital to maintain a strong capital base so we can withstand the extreme economic markets that come along from time to time.

Securian is proud of the competitive interest crediting rates of its general account Stable Value options. When fairly benchmarked against the universe of Stable Value investment options, Securian’s option has provided competitive returns, particularly in light of the liquidity provisions and risks associated with Stable Value investments.

Appendix D illustrates the Gross Performance for our Guaranteed Return Account which is a Minnesota Life General Account Stable Value option.

B. Stable Value Investments – Types 2 and 3

Securian has evaluated the risks of offering a Stable Value investment in a separate account (Type 2) or trust with one or more wrapper providers (Type 3). This analysis included putting the investment option through a variety of economic scenarios.

After each review, we have remained convinced that the risks of these investment options are higher than what is being reflected in the industry. Because these investment options lack the excess capital of insurance companies, we feel they are less able to withstand severe economic environments. Securian is unwilling to be a fiduciary with regard to Stable Value investment options offered through a separate account or a trust.

We also concluded that the risks are not always appropriately valued by wrap providers. The cost of ensuring the benefit responsive payments and the book value accounting had trended to less than 0.10% of assets. We believe this is unrealistically low relative to the cost of a meaningful Stable Value guarantee where there is no excess capital. While Stable Value investments have operated in a very “friendly” economic environment of generally declining interest rates, adverse economic conditions could cause issues such as:

- significant increases in the cost of these guarantees;
- a decrease in interested wrap providers; and
- a significant decline in wrap provider capacity.

As wrap providers become more aware of the actual risks that they are taking, it is noteworthy that provisions of the contract or Offering Memorandum may often be used to protect the provider’s own interests, to the detriment of Stable Value investors.

In 2004, the Securities and Exchange Commission (SEC) conducted a review of the existing Stable Value mutual funds and the account (“book”) values employed by these funds. The SEC has oversight of mutual funds and expressed concern that these funds were not well understood. All Stable Value investments were transformed into short-term bond funds or terminated shortly thereafter.

The remaining Stable Value trust investments used in retirement plans are under the jurisdiction of the Department of Labor (DOL) and not the SEC.

Securian recognizes the possibility that a significant decline in the market value of the assets precipitated by a rapid run up in interest rates, a period of high defaults, or decreased asset liquidity could produce a significant loss to Stable Value investors in a separate account or wrap guaranteed investment option. For many plans, this is their only low risk investment option. Offering participants the ability to preserve capital in any economic scenario is important. The economic scenarios that make the low risk option very attractive to plan participants are often at the same times when the risks of that option are elevated.

VI. Conclusion

Plan fiduciaries should not allow themselves to be lulled into complacency. The historical stability of returns of Stable Value investments obscures their inner-workings. While the risks may be appropriately managed, the plan fiduciary can not presume this to be the case. A plan fiduciary must apply a prudent process that observes the facts and circumstances. Otherwise, the interests of plan participants may not be adequately protected.

Securian is unwilling to be a fiduciary with regard to Stable Value investment options offered through a separate account or a trust.

Appendix A:

Risk-Based Capital and Regulatory Actions*

State Insurance Commissioners are charged with assessing an insurance company's ability to meet its obligations to its policyholders. In general, insurance companies must comply with the state regulations applicable to their state of domicile. This oversight is primarily focused on the relationship between the insurance company's assets and liabilities.

The market value of the entire insurance company's assets must exceed the total of all liabilities of the insurance company. This is called "excess capital". State statutory regulations require insurance companies to hold a minimum amount of required excess capital. The minimum amount of capital is determined specifically for each insurance company based on the risks of the assets in the general account and the products that they offer and is defined as "risk-based capital."

Because insurance companies are regulated at the state level, variations in state specific regulations have the ability to affect "risk-based capital" ratings. The National Association of Insurance Commissioners (NAIC) determines the calculation methodology for risk-based capital. The level of required risk-based capital is calculated by the insurance company and reported annually in its Blue Book which is filed with state insurance regulators.

Regulatory actions are determined by the ratio of the Total Adjusted Capital to the minimum risk-based capital. As the ratio falls below 200%, the NAIC has defined four RBC Action Levels:

- **Company Action Level** (Total Adjusted Capital of 150 to 200% of minimum risk-based capital) – Insurance Company must file a plan of action with the state insurance commissioner.
- **Regulatory Action Level** (Total Adjusted Capital of 100 to 150% of minimum risk-based capital) - Insurance regulators perform examination and analysis to ensure that the company plan of action is adequate.
- **Authorized Control Level** (Total Adjusted Capital of 70 to 100% of minimum risk-based capital) – State has authorization to take control of the insurance company but it is left up to the discretion of the insurance commissioners.
- **Mandatory Control Level** (Total Adjusted Capital of less than 70% of minimum risk-based capital) - State is required to take control of the insurance company.

The state regulatory requirements for insurance companies are actually a risk mitigator for Type 1 Stable Value investors. The oversight of the State Insurance Commissioners to ensure insurance company solvency can be viewed as a strong support mechanism for plan fiduciaries.

*Source: www.naic.org/documents/committees_e_capad_RBCoverview.pdf

Appendix B

Fiduciary Considerations for:

Type 1: Insurance Company General Account Stable Value Investments

Type 2: Insurance Company Separate Account Stable Value Investments

We believe in fulfilling their fiduciary obligations, plan fiduciaries should make a formal request – at least annually – for the information listed below for their Stable Value investment option and the provider of the option.

Quarterly financials may not be audited or available immediately after the end of a reporting period. The fiduciary should get an understanding of when financial information becomes available and whether such information is audited. For most situations, plan fiduciaries should use the most current information possible while doing their analysis.

1. Ratio of the Total Adjusted Capital to the minimum risk-based capital
2. Rating agency ratings of insurance company
3. Breakdown of asset quality and types of investments of general account
4. Transfer provisions of the Stable Value option
5. Termination provisions
6. Minimum interest rate guarantees
7. Frequency of crediting rate reset
8. Historical returns
9. How contract asset charges affect crediting rate determination

Appendix C

Fiduciary Considerations for:

Type 3: Wrap Guaranteed Stable Value Investments

We believe in fulfilling their fiduciary obligations, plan fiduciaries should make a formal request – at least annually – for the information listed below for their Stable Value investment option.

As market value is utilized in the setting of crediting rates, it should be available shortly after the end of a reporting period. Of course, you should allow for some time for the investment firm to do its compliance and legal review.

1. Current ratio of market value of asset portfolio to book value of total account values
2. Breakdown of underlying investments by asset quality and types of investments
3. Listing of wrap agreement providers and evidence of their financial strength (e.g., audited financial information, regulatory related filings, rating information, etc.)
4. Cost of wrap agreements and contractual provisions including time period of commitment and ability of wrap provider to exit its agreement
5. Investment expenses of trust
6. Transfer provisions
7. Termination and withdrawal provisions
8. Minimum rate guarantee
9. Frequency of rate of return determination
10. Historical returns
11. Delineation of all events that may cause withdrawals to be considered “withdrawal initiated by plan sponsor” rather than “participant withdrawal.”

Appendix D

Minnesota Life General Account Stable Value Option — Guaranteed Return Account

Gross Performance and Standard Deviation as of April 30, 2009

1 Month Average Return	.39%
3 Month Average Return	1.16%
YTD Average Return	1.57%
1 Year Average Return	4.78%
3 Year Average Annualized Return	4.72%
5 Year Average Annualized Return	N/A
10 Year Average Annualized Return	N/A
3 Year Standard Deviation	0.05%
5 Year Standard Deviation	N/A

Crediting Rate History

Effective Dates		A.	B.	C.
Beginning	Ending	Annualized Gross Crediting Rate	Contract Asset Charge	Annualized Net Crediting Rate
10/1/04	12/31/04	3.85%	The Contract Asset charge varies from client to client based on a myriad of factors. It is disclosed at the time of sale to the client and cannot change without advance notice to the client.	The Annualized Net Crediting Rate equals the Annualized Gross Crediting Rate (column A) minus the Contract Asset Charge (column B).
1/1/05	3/31/05	4.02%		
4/1/05	6/30/05	4.12%		
7/1/05	9/30/05	4.06%		
10/1/05	12/31/05	4.15%		
1/1/06	3/31/06	4.25%		
4/1/06	6/30/06	4.36%		
7/1/06	9/30/06	4.57%		
10/1/06	12/31/06	4.62%		
1/1/07	3/31/07	4.70%		
4/1/07	6/30/07	4.72%		
7/1/07	9/30/07	4.76%		
10/1/07	12/31/07	4.81%		
1/1/08	3/31/08	4.81%		
4/1/08	6/30/08	4.73%		
7/1/08	9/30/08	4.73%		
10/1/08	12/31/08	4.76%		
1/1/09	3/31/09	4.86%		
4/1/09	6/30/09	4.80%		

Description of the Guaranteed Return Account:

The Guaranteed Return Account is backed by the general assets of the Minnesota Life Insurance Company. This account guarantees principal and a rate of return that is set quarterly. The guarantees for the Guaranteed Return Account are solely based on the financial strength and claims-paying ability of Minnesota Life.

The history shown above dates back to the 4th Quarter 2004 inception of the Guaranteed Return Account.

Although the crediting rate is reset each quarter, the rate is stated on an annualized basis.

The minimum guaranteed annual net crediting rate for the Guaranteed Return Account is 1.50%.

About Securian Financial Group, Inc.

Since 1880, **Securian Financial Group** and its affiliates have provided financial security for individuals and businesses in the form of insurance, investments and retirement plans. Now one of the nation's largest financial services providers, it is the holding company parent of a group of companies that include Minnesota Life Insurance Company.

Securian Retirement, a unit of Minnesota Life Insurance Company, offers a full range of retirement products and services to individuals, plan sponsors and advisors. The information presented here refers specifically to our 401(k) and other qualified retirement plan programs. All of our retirement plan products are offered through a group variable annuity contract issued by Minnesota Life.



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