

## MEMORANDUM

**TO:** File No. S7-32-11

**FROM:** Brian P. Murphy  
Counsel to Commissioner Walter  
Office of Commissioner Walter

**DATE:** November 15, 2011

**RE:** Meeting with Representatives of the Stable Value Investment Association  
("Meeting Participants")

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On the above date, Commissioner Walter and Brian P. Murphy met with the Meeting Participants to discuss the above referenced file number. The Meeting Participants provided the attached document and following list of attendees:

- Gina Mitchell, SVIA President
- Tony Camp, ING
- James King, Prudential Financial
- Steve Kolocotronis, Fidelity Investments
- Marc Magnoli, JP Morgan Chase
- Brad Bondi, Cadwalader, Wickersham & Taft LLP
- Tony Mansfield, Cadwalader, Wickersham & Taft LLP
- Jonathan Flynn, Cadwalader, Wickersham & Taft LLP



# Stable Value Funds Overview



## Stable Value Investment Association

- ▶ Dedicated to educating plan sponsors and the public on the importance of saving and investing for retirement and the contribution that stable value funds can make to a financially secure retirement
- ▶ Voice for the stable value investment community on issues affecting stable value and retirement security
- ▶ Represents all segments of the stable value investment community: plan sponsors, investment managers, bank issuers and insurance issuers
- ▶ Members collectively manage almost \$540 billion in stable value assets



# Why Stable Value Is a Key Part of Asset Allocation

- ▶ Stable value is a fundamental component of defined contribution plans because it offers:
  - » Principal protection
  - » Steady, predictable returns consistent with a conservative principal protection vehicle
  - » Benefit-responsive liquidity
- ▶ Stable value is a low-risk, cost-effective investment option used by millions of participants to achieve their desired risk tolerance in asset allocation
- ▶ Participants who invest in stable value funds are:
  - » Retirees or individuals nearing retirement who will begin to access retirement funds now or in the near future
  - » Conservative investors who seek a core portfolio that provides an attractive return coupled with the opportunity for low volatility and preservation of capital
  - » Moderate or aggressive investors seeking diversification to enhance their overall portfolio risk-adjusted returns
  - » Individuals seeking an alternative to money market funds and short-term bond funds
  - » Individuals who have been placed in a stable value fund by default because they have not made an asset allocation decision.

*Funds to the left have potentially more inflation risk and less investment risk*

*Funds to the right have potentially less inflation risk and more investment risk*

Money  
Market  
Funds

Stable  
Value  
Funds

Bond  
Funds

Balanced  
Funds

Growth & Income  
Funds

Growth  
Funds

International/Global  
Equity Funds

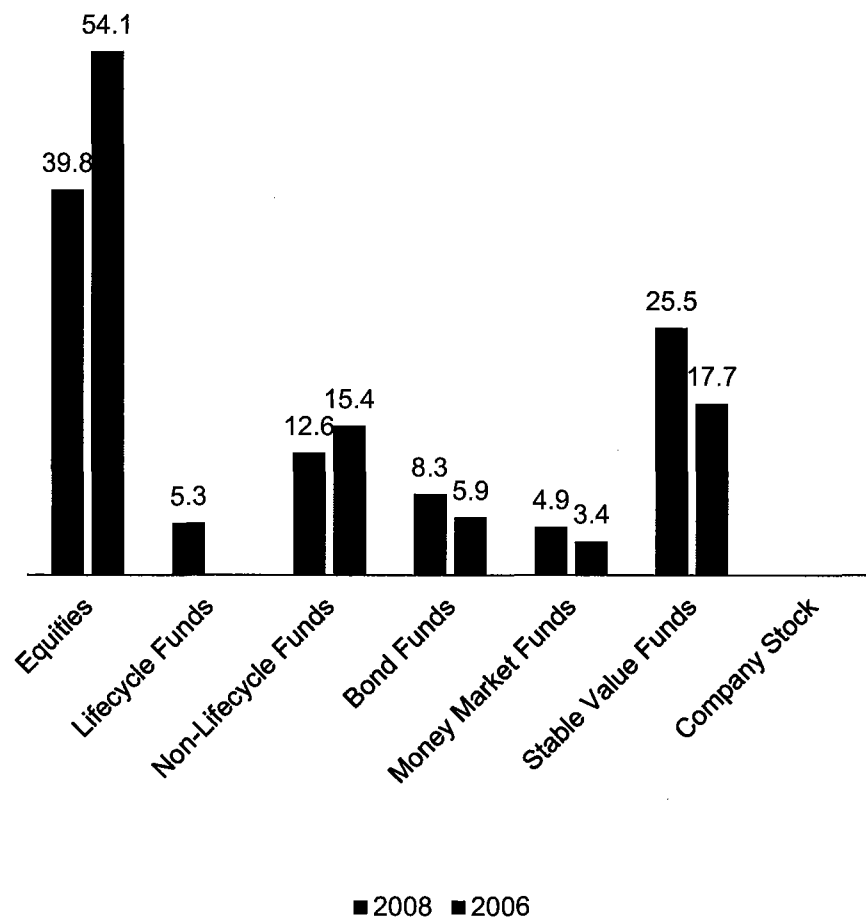
Specialty  
Funds

Company  
Stock

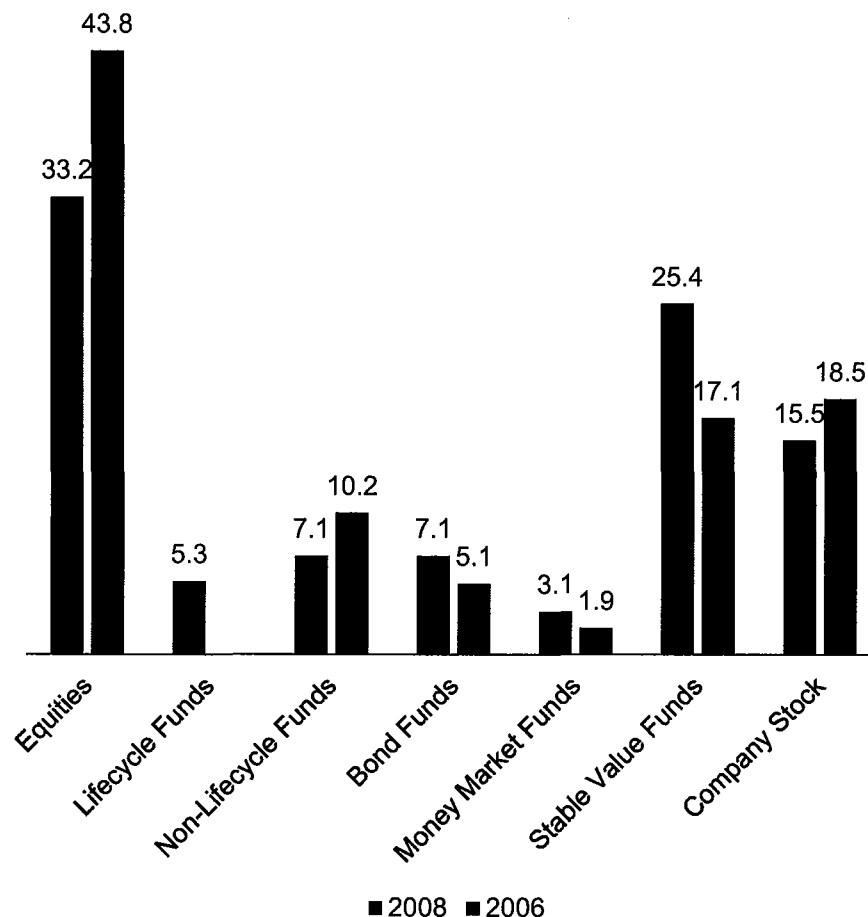
**SVIA**

# 401(k) Plans that Offer Stable Value Funds

**Average Asset Allocation of 401(k) Accounts for Plans with Stable Value Fund Investment Option and No Company Stock**



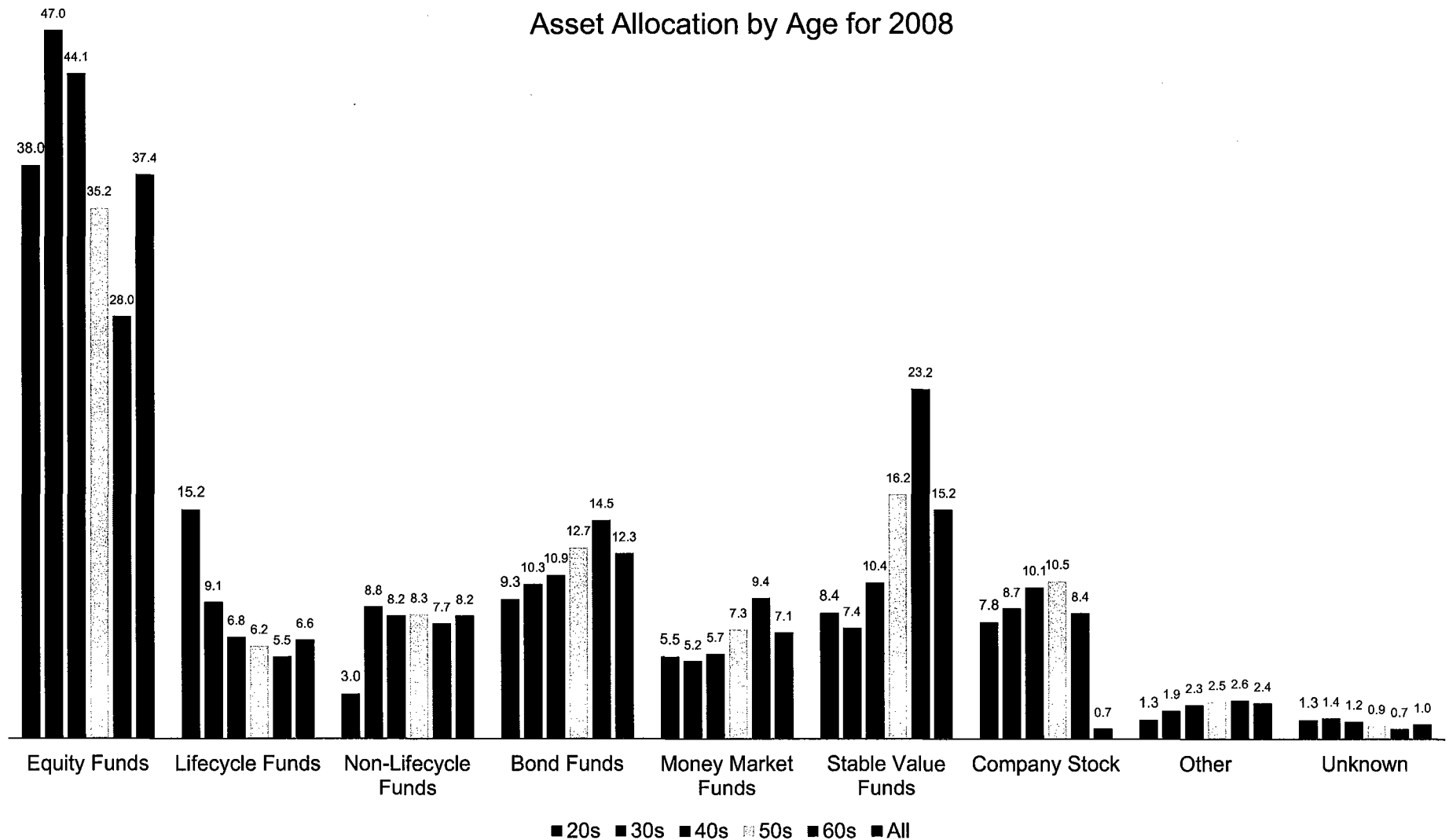
**Average Asset Allocation of 401(k) Accounts for Plans with Stable Value Fund Investment Option and Employer Stock**



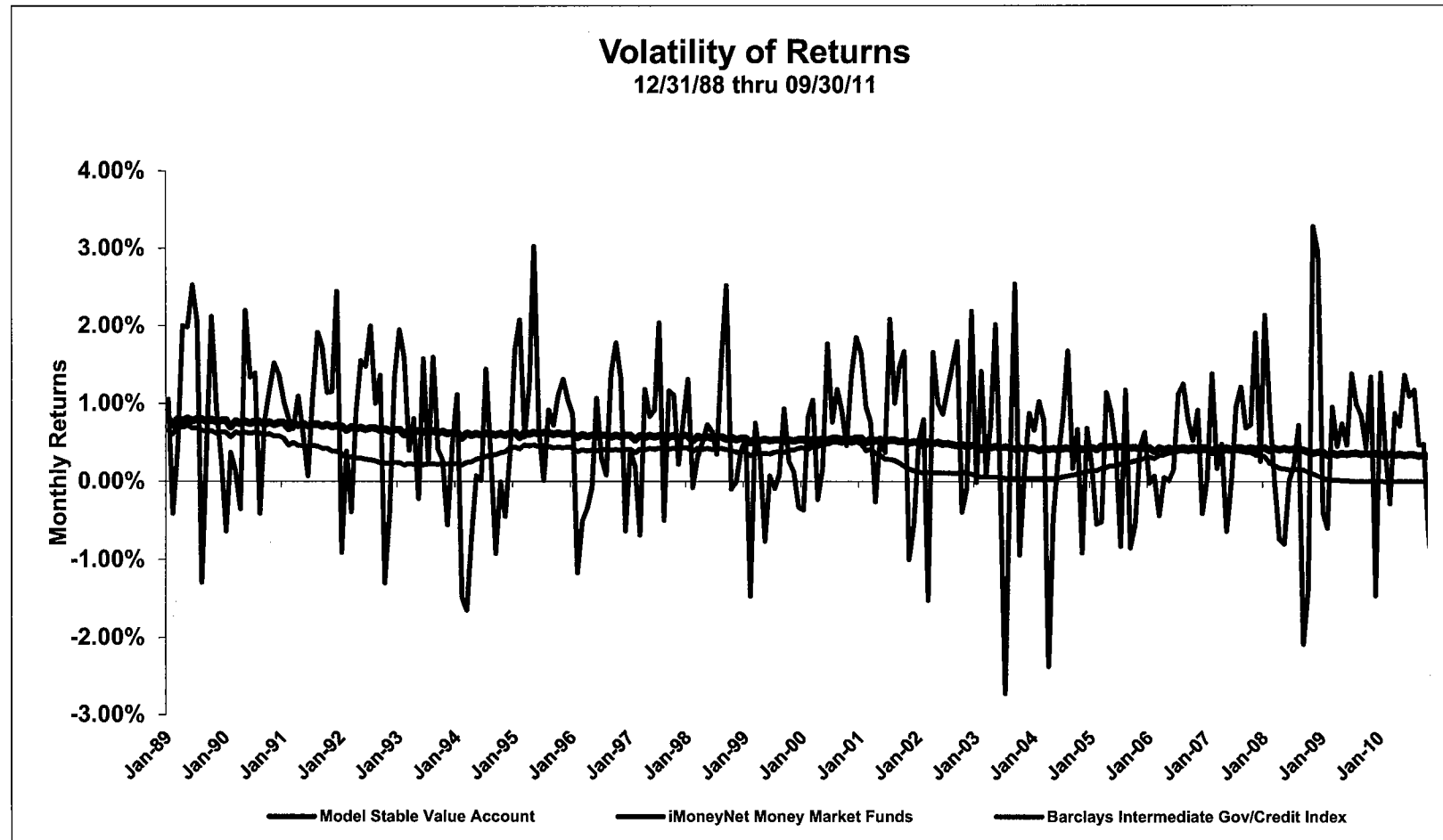


# Participants of All Ages Use Stable Value

## Asset Allocation by Age for 2008



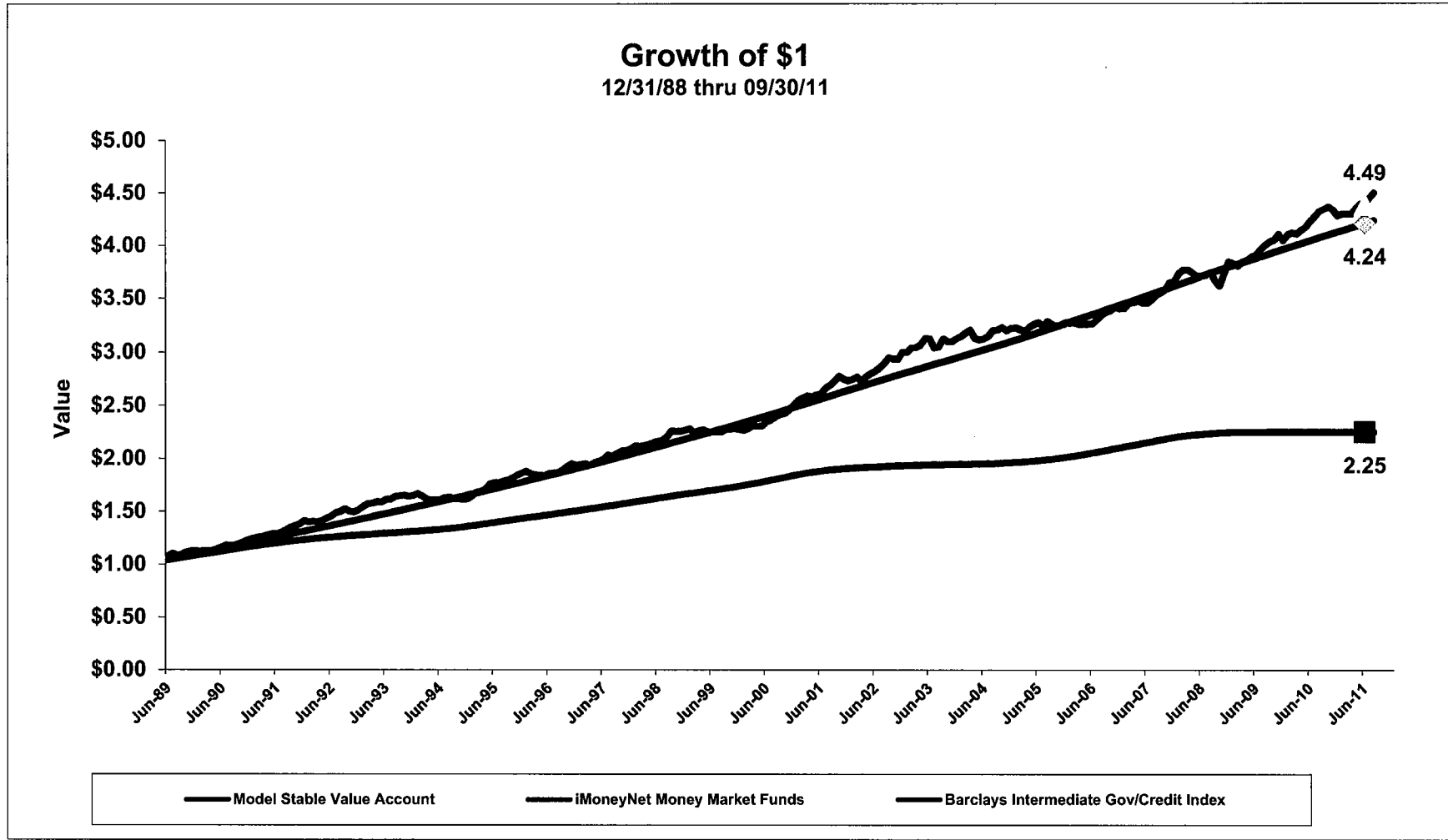
# Stable Value Provides Capital Preservation and Consistent, Steady Returns



Sources: Stable Value Investment Association, iMoneyNet Money Market Funds and Barclays Intermediate Gov/Credit Index



# Stable Value Offers Higher Return Potential than Money Market Funds



Sources: Stable Value Investment Association, iMoneyNet Money Market Funds and Barclays Intermediate Gov/Credit Index



## Benefit Responsiveness Distinguishes Stable Value From Other Asset Classes

- Benefit-responsiveness means participants transact at book value (principal plus accrued interest)
  - ▶ Benefit responsiveness helps the stable value fund achieve the following objectives:
    - » Principal preservation with capital appreciation
    - » Consistent, conservative returns
    - » Returns similar to bond funds with the liquidity of money market funds
  - ▶ Benefit responsiveness is provided through one or more different types of investment contracts
  - ▶ Benefit responsiveness criteria is established by the Financial Accounting Standards Board (FASB) and *all five requirements must be met*



## FASB Requirements for Benefit Responsiveness

► FASB established criteria for benefit responsiveness in FSP AAG INV-a. All must be satisfied:

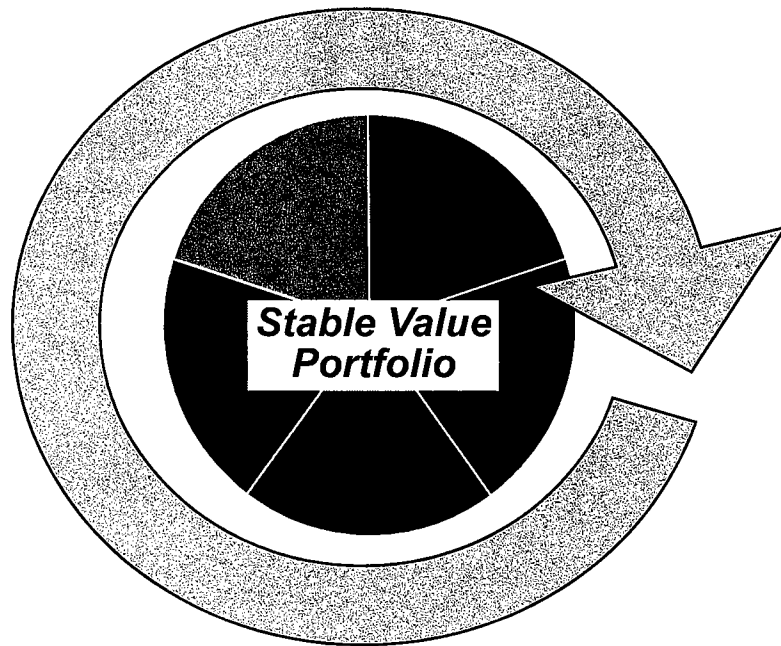
- 1. Investment contract is effected directly between the fund and issuer and prohibits the sale or assignment of the contract or its proceeds to another party without the consent of the issuer*
- 2. The repayment of principal and interest credited to participants in the fund is a financial obligation of the issuer of the investment contract, or prospective interest crediting rate adjustments are provided to participants in the fund on a designated pool of investments held by the fund or a contract issuer who is a financially responsible third party and provides assurances that the adjustments to the interest crediting rate do not result in a future interest crediting rate that is less than zero*
- 3. The terms of the investment contract require all permitted participant-initiated transactions with the fund to occur at book value*
- 4. An event (such as bankruptcy) that limits the ability of the fund to transact at book value with the issuer and that also limits the ability of the fund to transact at book value with participants in the fund must not be probable of occurring*
- 5. The fund itself must allow participants reasonable access to their funds*

## How Benefit Responsiveness Is Achieved

- ▶ Benefit responsiveness is the ability of plan participants to transact at book value (principal plus accrued interest)
  
- ▶ Benefit responsiveness is delivered by a stable value investment contract from a financially sound bank or insurance company that provides redemption at book value (principal plus accumulated interest), regardless of the level of market value
  
- ▶ Stable value investment contracts are:
  - » Guaranteed Interest Contracts and/or other General Account Contracts
  - » Separate Account Contracts
  - » Synthetic GICs
  
- ▶ Stable value funds may hold one contract type or some combination of these investment contracts

# How Benefit Responsiveness Works

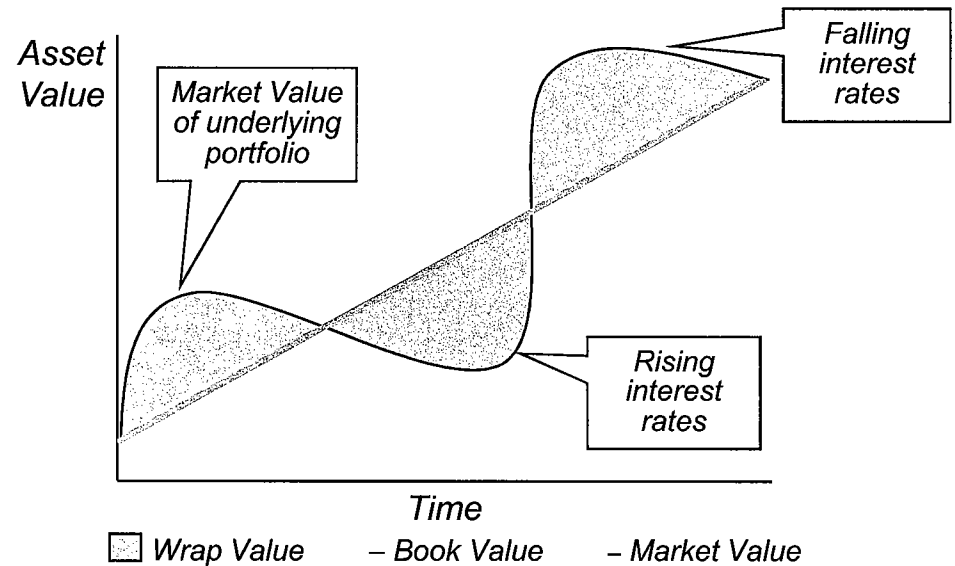
*Managed portfolio  
of high-quality, fixed income securities*



**Investment  
Contracts**

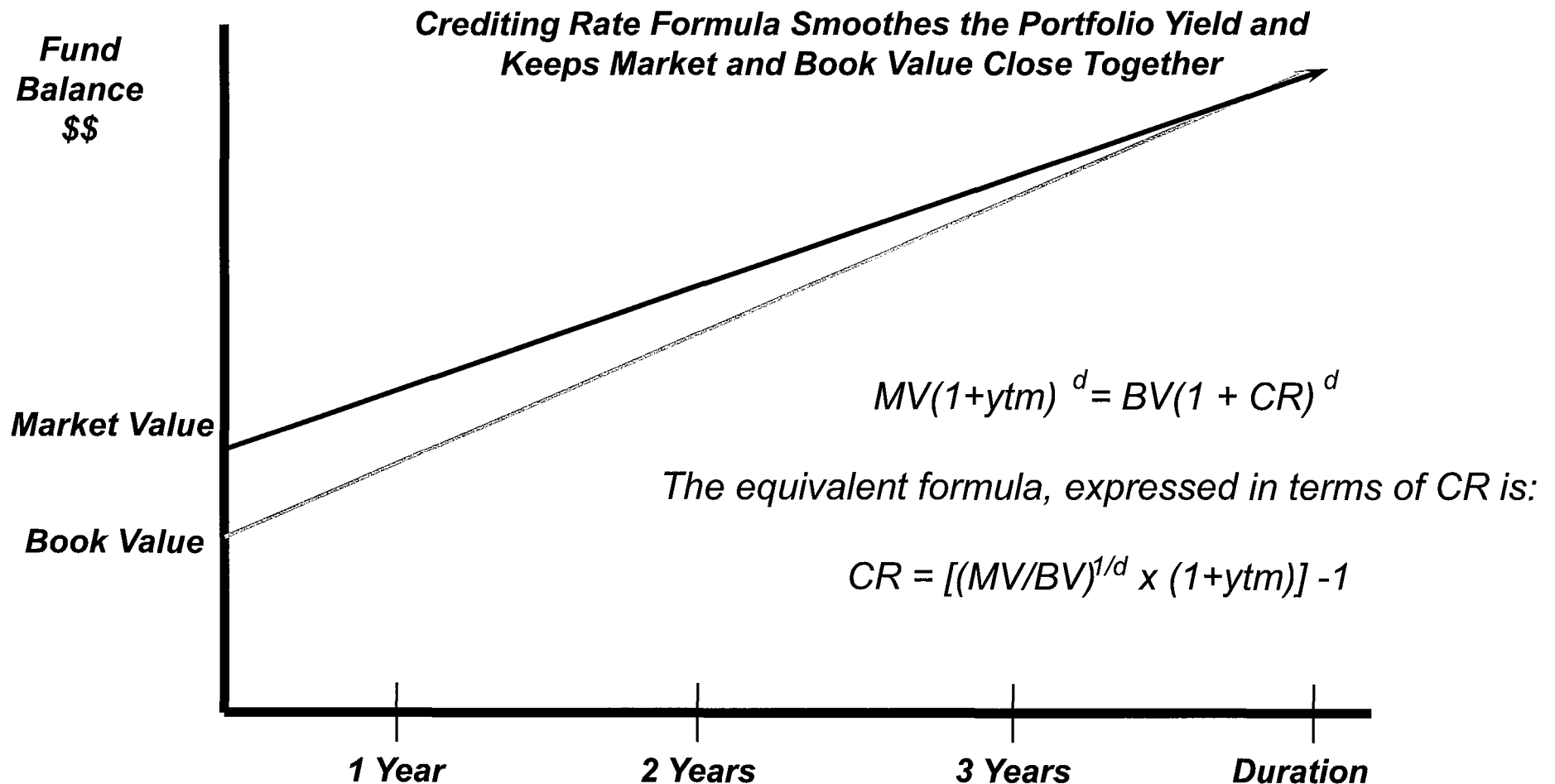
*Stable Value Fund*

- *The book value investment contract provides preservation of principal and a stable crediting rate*
- *The investment contract smoothes market volatility by amortizing gains and losses over the duration of the portfolio*
- *This smoothing is triggered through the rate reset mechanism and insulates against day-to-day volatility*



**SVIA**

# Benefit Responsiveness: How Market Value and Book Value Converge

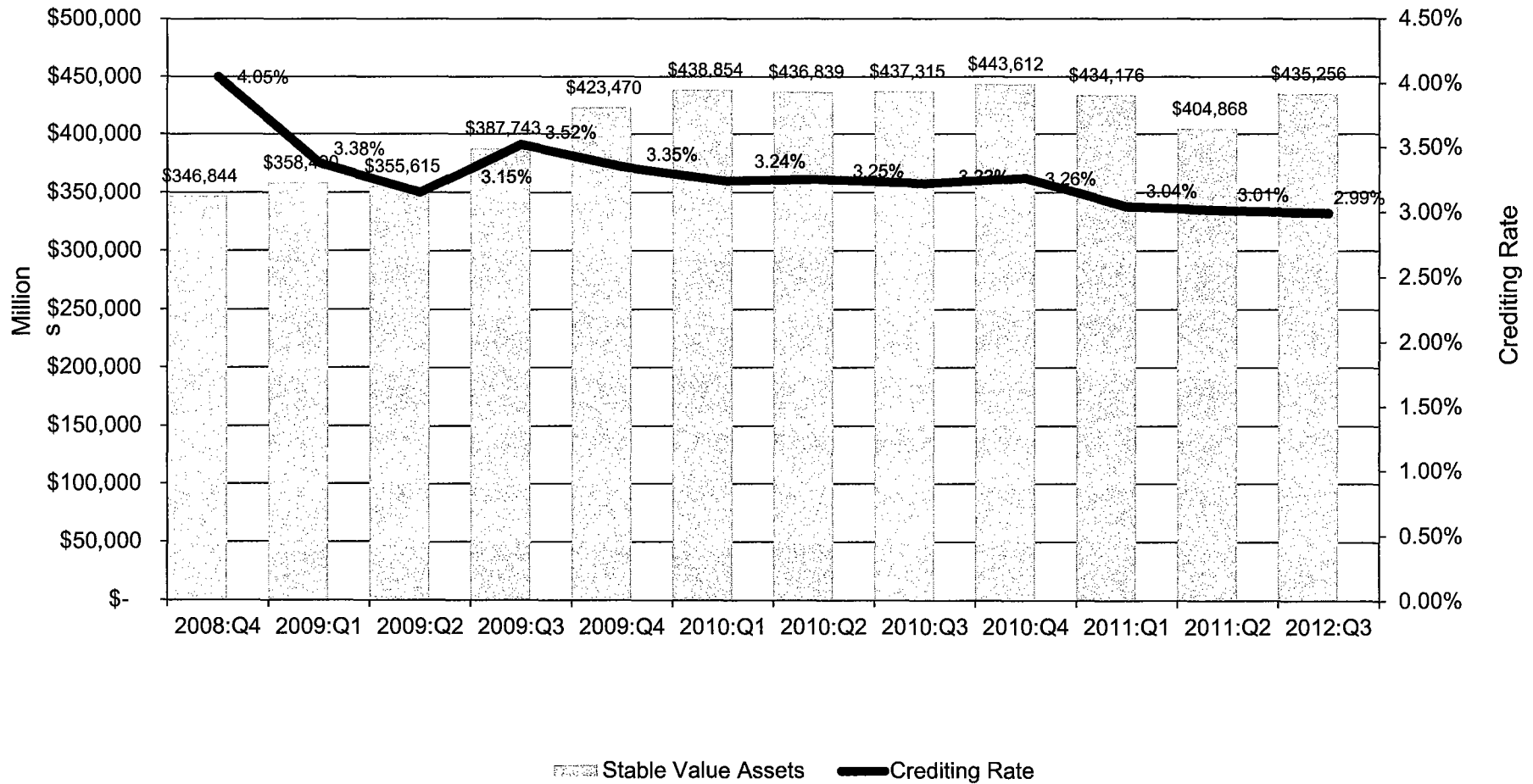




## Characteristics of a Stable Value Portfolio

- ▶ High credit quality, fixed income securities
  - » Portfolios will have an investment grade strategy
  - » *On average, overall credit quality is AA or better, duration is 4.00 years for \$540 billion as of December 31, 2010*
- ▶ Broadly diversified
  - » In general, the exposure to any single issuer of investment securities typically does not exceed five percent of fund assets
- ▶ Balances duration with crediting-rate responsiveness
  - » *Crediting rates are 3.43% for \$540 billion as of December 31, 2010*
- ▶ Maintains a source of ready liquidity
  - » Portfolios should be structured to provide sufficient liquidity when needed for plan benefits
- ▶ Each characteristic should be viewed and evaluated as a component of the total, overall strategy employed

# Stable Value Funds Continue to be a Valued Investment



Source: SVIA Stable Value Quarterly Characteristics Survey through March 2011.

 For more information:

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