Stable Value Investment Association

Stable Value Guaranteed Insurance Accounts:

Frequently Asked Questions

This FAQ is limited to an overview of guaranteed insurance accounts and focuses primarily on 'spread-based' general account insurance products. For simplicity, the FAQ assumes a plan uses only one guaranteed insurance account product for the entirety of its stable value investment option. The FAQ does not address all the variations of guaranteed insurance accounts or the combination of stable value products that may be used by a plan. This FAQ does not discuss or compare other stable value products such as synthetic GICs or differences in investment management. For more information about stable value products other than guaranteed insurance accounts, please see www.stablevalue.org.

Stable Value Guaranteed Insurance Accounts:

Frequently Asked Questions

Stable Value - Guaranteed Insurance Accounts

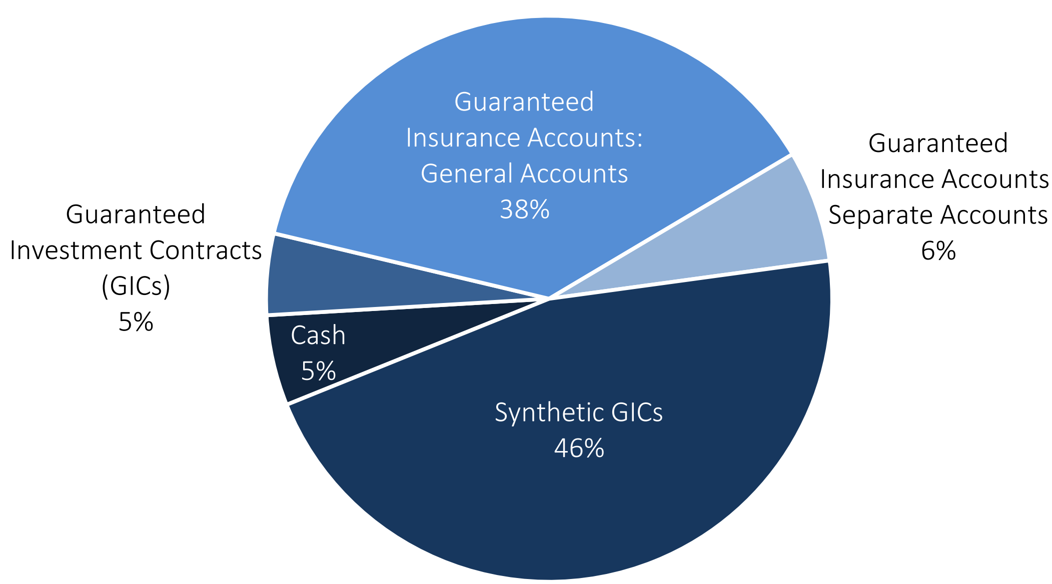
Given the complexity and uncertainty of today's financial markets and economy, it is no wonder that plan sponsors and plan participants continue to appreciate the benefits of stable value. As of December 31, 2011, over 25 million plan participants in more than 159,000 defined contribution plans invested $645.5 billion in stable value products.[1] Throughout their 40 year history, stable value products have consistently delivered a unique combination of benefits: liquidity, principal preservation, and consistent, positive returns. Stable value's unique characteristics are called "benefit responsiveness." The standards that determine stable value's benefit responsiveness are set by the Financial Accounting Standards Board as well as the Governmental Accounting Standards Board.

Stable value products, regardless of the product or how it is managed, have weathered various economic cycles and consistently performed in meeting the needs of plan participants and their beneficiaries. While stable value continues to deliver as promised, the challenges of the financial crisis and the Great Recession have resulted in subtle changes within the stable value landscape. Insurance companies have become more prominent, and have over $281 billion outstanding in guaranteed insurance accounts.

Because of the significant allocation of assets to guaranteed insurance accounts and the scant amount of publicly available information, the following FAQ seeks to shed some light on this segment. This FAQ is limited to an overview of guaranteed insurance accounts and focuses primarily on 'spread-based' general account insurance products. For simplicity, the FAQ assumes a plan uses only one guaranteed insurance account product for the entirety of its stable value investment option. The FAQ does not address all the variations of guaranteed insurance accounts or the combination of stable value products that may be used by a plan. This FAQ does not discuss or compare other stable value products such as synthetic GICs or differences in investment management.[2]

$645.5 Billion Invested in Stable Value Products

Product allocation as of December 31, 2011



What is a stable value guaranteed insurance account?

Guaranteed insurance accounts are stable value products that are offered to defined contribution plans such as 401(k), 457, 403(b) and some 529 tuition assistance plans on a full service or investment only basis, generally managed entirely and guaranteed directly by a single insurance company.[3] The guaranteed insurance account generally represents the entire stable value investment option. Further, a recent SVIA survey found that guaranteed insurance account general accounts represent thirty-eight percent of stable value assets.[4]

Guaranteed insurance accounts are provided via a group annuity contract or a funding agreement that can be issued from either the general account or a separate account of the insurer. The underlying assets are typically managed by the insurance company or an affiliated manager.

In all cases, guaranteed insurance accounts are backed by the full financial strength and credit of the issuing insurance company.

[Back to Top]

How do guaranteed insurance accounts serve the needs of defined contribution plans and their participants?

Guaranteed insurance accounts are similar to other stable value products that are used in pooled funds or individually managed funds since they all deliver principal preservation, cash like liquidity for participant driven transactions, and consistent, positive returns that are generally higher than money market funds. Guaranteed insurance accounts often cater to the needs of small to medium-sized plans.

Stable value products are tailored to meet the needs of a specific plan participant population and/or group of plans and their plan participants. While all stable value products deliver the same basic benefits, there are differences in structure, levels of guarantees, as well as some contractual features. Having this multitude of structures enables plan fiduciaries to select the stable value product that is best suited to their specific plan participants' needs. The chart below provides an overview of stable value products.

[Back to Top]

Stable Value Product	Description	Rate of Return	Assets
Guaranteed Insurance Accounts: General Accounts[5]	Contracts and agreements with an insurance company that provide principal preservation, benefit responsiveness, and a guaranteed fixed or indexed rate of return backed by the assets of the insurer's general account.	Guaranteed regardless of the performance of the underlying assets.	Owned by the insurance company and held within the insurer's general account.
Guaranteed Insurance Accounts: Separate Accounts	Contracts and agreements with an insurance company that provide principal preservation, benefit responsiveness, and a guaranteed rate of return backed first by assets held in a segregated account separate from the insurer's general account and then, to the extent there are any shortfalls, by assets in the general account.	May be fixed, indexed, reset periodically, or based on the actual performance of the segregated assets.	Owned by the insurance company but set aside in a separate account for the exclusive benefit of the plan(s) in the separate account.
Synthetic GICs	Contracts and agreements with a bank or insurance company that provide principal preservation, benefit responsiveness, and a guaranteed rate of return relative to a portfolio of assets held in an external trust and backed by assets held in the trust.	Provides a periodic rate of return based on the actual performance of the underlying assets.	Directly owned by the participating plan(s).

What are the strengths of guaranteed insurance accounts?

In addition to providing an attractive solution to plans and participants seeking stability, liquidity, and yield, guaranteed insurance accounts provide the following benefits:

- Guaranteed Minimum Interest Rate - While minimum rates vary by structure and type of product, all stable value contracts guarantee a minimum rate of at least zero percent, which ensures principal preservation. Guaranteed insurance account structures often guarantee the minimum rate at higher than zero percent, typically varying from one to three percent. At no stage in the life of the contract can the actual crediting rate fall below the guaranteed minimum rate which is nondiscretionary and contractually stated.

- Crediting Rates - Rates are often fixed and guaranteed in advance for up to one year (sometimes longer) and must be greater than or equal to the guaranteed minimum rate. The crediting rate and its terms are defined in the contract.

- Policyholder Status - These insurance contracts or policies are backed by the full faith and credit of the insurance company. Claims under the guaranteed insurance account are pari-passu with other policyholders and ahead of general creditors to the insurance company.[6]

- Direct Guarantee - The guaranteed insurance account contract is issued directly to the plan sponsor or trustee who receives a guarantee of benefit responsiveness from the insurer.

- Option to Annuitize Savings - Guaranteed insurance account contracts in the retirement plan universe typically offer participants the option upon retirement of withdrawing money as needed or annuitizing (converting their balances into a regular income stream for life).

- Regulatory Safeguards - State insurance regulators oversee insurer reserves and investments through regulation and regular audits.

- Strong Risk Management - Guaranteed insurance accounts are regulated as guaranteed products and the insurance industry employs a rigorous risk controlled approach to issuing and managing them.

- Broad Usage and Capacity - Guaranteed insurance account contracts are flexible and broadly available across multiple plan types offering capacity to the marketplace.

[Back to Top]

What risks does the insurer bear for providing the guarantees?

By declaring a rate in advance that can never fall below the guaranteed minimum interest rate, the insurance company assumes certain risks[7] such as:

- **Duration or Interest Rate Risk** - Longer duration assets expose the insurance company to potentially larger price fluctuations as interest rates move.
- **Investment Risk** - Lower than expected returns on investments, risk of default, credit impairment, underperformance, pre-payments or extension risk.
- **Liquidity Risk** - Certain portfolio allocations may not be readily tradable under certain market conditions.
- **Cash Flow Risk** - Actual plan and participant cash flows may be significantly different than what was anticipated when the crediting rate was declared.
- **Capital Risk** - If assumptions used while declaring the rate were incorrect and actual earnings are insufficient to cover the risks the insurer bears, capital is reduced.

[Back to Top]

How does an insurer take on these risks?

Transferring risk from policyholders to the insurance company is at the very heart of what insurance companies do every day. Buying an insurance policy is purchasing a promise from the insurance company to pay on its guarantees and obligations. The insurer assumes risks in providing these guarantees for which it needs to be compensated in order to meet its commitment to policyholders and to maintain adequate capital and a viable business.

In order to provide guarantees insurance companies are required to hold capital and build reserves for their lines of business. The capital deployed has to earn a minimum required return that varies by company. Internal management as well as regulatory bodies and rating agencies rigorously monitor the sources, uses, risk, and return on capital. Profits earned increase capital levels, help preserve the financial strength of the company, and ensure that the company can meet contractual obligations, all of which benefits policyholders.

[Back to Top]

What are general accounts and separate accounts? How do they relate to guaranteed insurance accounts?

Guaranteed insurance accounts can be structured in two ways: general accounts or separate accounts. In the general account structure the assets are invested in and owned by the insurance company's general account, which means that the entire general account of the insurance company, and effectively the ultimate claims paying ability of the insurer, supports the stable value guarantees. The assets in a general account are not attributable to any single policyholder or liability, and the Employee Retirement Income Security Act (ERISA) excludes the assets supporting these guaranteed insurance accounts from the definition of plan assets and treatment as plan asset as long as they are guaranteed benefit policies.[8]

Separate accounts differ from general accounts in that the assets are segregated from the general account of the insurer. The guarantees for the specific plan are first backed by the separate account, and only if the separate account assets are insufficient would the general account step in to make up any potential shortage.

Apart from the structural differences, both the general account and separate account contracts are remarkably similar in how each delivers stable value's benefit responsiveness. Benefit responsiveness provides stable value's distinct combination of characteristics: liquidity, principal preservation, and consistent, positive returns, and the ability of plan participants to transact at contract value, which is principal plus accumulated interest.

[Back to Top]

Why are the disclosure requirements for guaranteed insurance accounts different from other 401(k) investments?

Because there are different types of stable value products and differences in how they are structured, there are also differences in their disclosure requirements. Stable value products that have wraps such as synthetic GICs and some separate accounts[9] are very similar to other fee-based 401(k) plan investments in terms of disclosure. They are similar since the rates of return for these products are tied directly and contractually to the performance of the underlying portfolio over time. These stable value products have crediting rates that are reset using contractual formulas to pass through the investment performance of the underlying assets. Because of this, they are required to provide detailed listings of the underlying portfolio holdings to plan sponsors as well as meet the Department of Labor's (DOL) fee disclosure requirements.

While there are variations, guaranteed insurance accounts differ because they declare and guarantee a rate for up to a year or longer in advance and also provide a minimum guaranteed rate of return regardless of the performance of the assets. In the case of general account guaranteed insurance accounts, the rate is not tied directly to the investment performance of a specific underlying portfolio but is instead based on the entire general account of the insurer. Because assets in the general account support guarantees made to all policyholders under multiple lines of business, they are not attributable to or dedicated to any specific contract. For interested parties, general account investment holdings are available through annual filings with state insurance departments.

[Back to Top]

What is a spread?

A spread is the difference between the actual earnings on investments and the crediting rate that is declared and guaranteed by the insurance company for a given period, which is subject to the minimum rate guarantee. An insurer attempts to earn a spread using assumptions based on many factors such as the magnitude and timing of deposits, participant cash flows, investment performance, rate environment, and potential credit impairments. Spread is used to compensate the insurer for risk, capital charges, and other expenses.

Spread does not equal profit. There is no certainty an insurance company will earn a targeted spread or any spread at all. However the stated rate of return to plan participants is guaranteed. Investment yields need to be greater than the rate credited to cover an insurer's expenses, and that is not always the case. If the investments underperform or if any of the assumptions are inaccurate the insurer is still held to the declared crediting rate and the guaranteed minimum rate.

Other products such as individual fixed annuities and certificate of deposits also earn a spread income that is expected to be higher than the guaranteed rate.

[Back to Top]

Why is it difficult to measure or compare spreads?

Spread earnings are prospective, variable, and unpredictable. Unlike the fees associated with products such as variable annuities or mutual funds, which do not offer a guaranteed rate or assume the risks previously outlined, guaranteed insurance account spreads are not fixed or scalable. There can even be situations of negative spread should there be sustained investment defaults, poor performance, or if cash flows are significantly adverse. In addition, spread also varies based on the insurer's specific structure of underlying assets, contract terms, and capital requirements. For these reasons, measurement and disclosure of guaranteed insurance account spreads do not provide the ability to perform meaningful product or insurer comparisons. Plan sponsors and their participants are better served to measure the return of the product's crediting rate, the product's historical performance, as well as the insurer's claims paying ability to assess the long term value of the guaranteed insurance account.

[Back to Top]

Why are guaranteed insurance accounts excluded from some of the Department of Labor's fee disclosure requirements?

The DOL excluded fixed return products from some fee disclosure under 408(b)(2) and subsequently stated that these products must "provide a fixed or stated rate of return to the participant for a stated duration" which guaranteed insurance accounts do during the rate guarantee period. The DOL defined fixed return products in the preamble to the fee disclosure regulations as "certificates of deposit, guaranteed investment contracts, variable annuity fixed accounts, and other similar interest bearing contracts from banks or insurance companies."[10]

In addition to being classified as a fixed return product, the supporting investments for general account guaranteed insurance contracts are managed collectively in the insurer's general account and are not earmarked to a specific liability.[11] The spread earned by the insurer is not fixed, changes continuously, is not known until after the expiration of the rate guarantee period, and as a result cannot be easily attributed to specific products for purposes of disclosure. The general account stands behind all products and liabilities, including life insurance products as well as annuities, whereas with other stable value products the fee is built into the product and deducted directly from an earmarked portfolio's return, allowing it to be reported and compared across similar products.

[Back to Top]

What are the plan's exit rights in guaranteed insurance accounts?

Contract termination options vary depending on the structure of the product but they are always disclosed in the underlying insurance contract. Typically contracts allow the plan to terminate the contract and receive proceeds at the contract value over a stated period of time, either in installments or a lump sum payment. During this period the contract remains fully benefit responsive to participants and is still subject to the guaranteed minimum rate. Many contracts also allow for an immediate lump sum payment at a calculated market value based on a stated formula.

[Back to Top]

How does a plan get comfortable with a single guarantor behind a guaranteed insurance account?

In addition to the fact that any claims related to guaranteed insurance accounts are pari-passu with other policyholders and ahead of general creditors, insurance companies are highly regulated with rigorous risk management and oversight processes and subject to periodic examinations by the state insurance departments. Reserves prescribed by insurance laws are held against the liabilities to protect against losses. Rating agencies, which assess an insurance company's financial strength and ability to meet claims, examine the insurer's guaranteed insurance accounts along with other products when assigning a financial strength rating.

Insurance firms have long histories in the guarantee business and a strong time tested commitment to the market. Guaranteed insurance accounts performed well through the credit crisis by consistently generating positive returns. These accounts are often flagship structures offered through the insurance company's retirement and other full service platforms and the company has a vested interest to preserve them. Plan fiduciaries perform their due diligence by learning about the financial health and longevity of the company both initially and on an ongoing basis to monitor developments.

Selecting the stable value solution that is best for a plan requires analysis of the different types of stable value products available, and while all stable value products seek to preserve capital and provide competitive returns, there are differences between the various types offered today. Considering and understanding these differences is fundamental to the selection, monitoring, and ongoing due diligence for stable value products.

For guaranteed insurance accounts, analyzing and understanding the financial strength of an insurer is important, as is evaluating the risks that these products address. Further, the Department of Labor's regulation on the selection of annuity providers safe harbor for individual plans[12] as well as Interpretive Bulletin 95-1, although intended for defined benefit plans' selection of annuity providers, offer frameworks for the analysis, selection, and monitoring of insurance company general accounts.

[Back to Top]

Notes

[1] SVIA's Stable Value Funds' Investment and Policy Survey covering stable value products as of December 31, 2011.

[2] For more information about stable value products other than guaranteed insurance accounts, please see www.stablevalue.org.

[3] Insurance companies offer several product variations for stable value. These products include:

- Non-participating fixed term traditional GICs issued by the general account.
- Open maturity general or separate account guaranteed products with a fixed rate for a period of time.
- Contracts with or without minimum floor guarantees that are in excess of zero percent.
- Fee-based synthetic wrap contracts or wraps that are issued by an insurance company separate account. These are held as an investment within the stable value fund along with other wraps/GICs procured from other issuers.

[4] Ibid, endnote 1.

[5] Guaranteed Interest Contracts (GICs) have characteristics similar to Guaranteed Interest Account General Accounts.

[6] Separate accounts are backed by the assets in the separate account first and then to the extent there is a potential shortfall, by the general account.

[7] For separate accounts whose crediting rate is determined by the performance of segregated assets, some of the risks described are borne by the plan, not the insurance company.

[8] ERISA Advisory Opinion 05-19A (U.S. Department of Labor, 2005).

[9] Ibid, endnote 7.

[10] Federal Register, Volume 75, Number 202, "Department of Labor, Employee Benefits Security Administration 29 CFR Part 2550, Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans; Final," page 64916.

[11] For simplicity, the various separate account arrangements are not addressed in this section of the FAQ.

[12] Federal Register, Volume 73, Number 195, "Department of Labor, Employee Benefits Security Administration 29 CFR Part 2550, Selection of Annuity Providers--Safe Harbor for Individual Account Plans," pages 58447-58450.

About the Contributors

Gina Mitchell

President
Stable Value Investment Association

Aruna Hobbs

Managing Director, Head of Stable Value Investments
New York Life Investment Management

Warren Howe

National Sales Director: Stable Value
Metropolitan Life Insurance Company

James King

Managing Director, Stable Value Strategic Relationships
Prudential Financial

Phil Maffei

Senior Director, Stable Value Products
TIAA-CREF

William McLaren

Vice President, Stable Value Business Leader
Lincoln Financial

Stable Value Investment Association

1025 Connecticut Ave NW Suite 1000
Washington, DC 20002
202-580-7620
www.stablevalue.org