GUARANTEED INSURANCE CONTRACTS
FREQUENTLY ASKED QUESTIONS

STABLE VALUE INVESTMENT ASSOCIATION

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STABLE VALUE INVESTMENT ASSOCIATION
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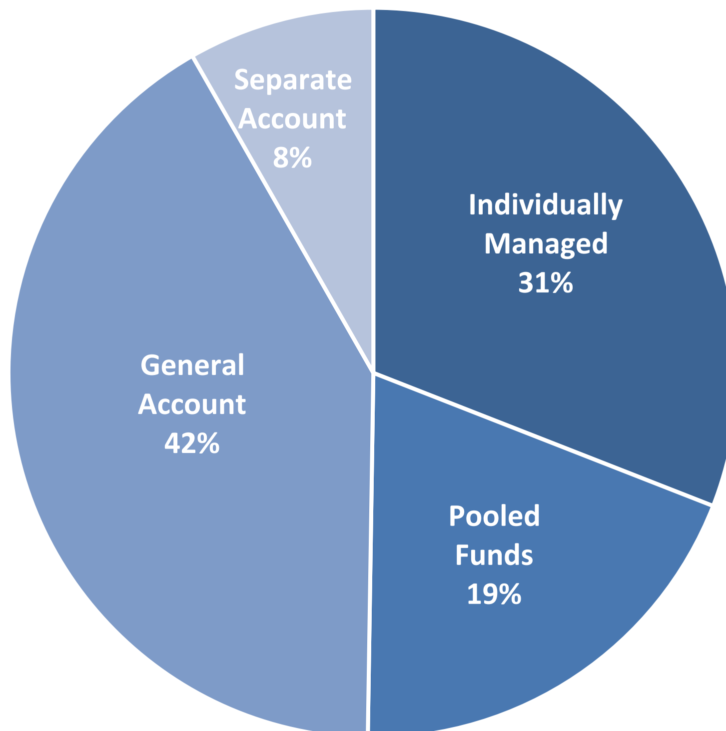
INTRODUCTION

Given the complexity and uncertainty of today's financial markets and economy, it is no wonder that plan sponsors and participants continue to appreciate the benefits of stable value. As of December 31, 2020, more than 185,000 defined contribution plans invested $902 billion in stable value products.[i] Throughout its 45 year history, stable value has consistently delivered a unique combination of benefits: liquidity, principal preservation, and consistent, positive returns.

Stable value funds 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 funds have weathered various economic cycles and consistently performed in meeting the needs of plan participants, there are differences in structure, levels of guarantees, as well as some contractual features. Because of the significant allocation of assets to guaranteed insurance accounts and the scant amount of publicly available information, the following frequently asked questions (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. The FAQ does not address all the variations of guaranteed insurance accounts or the combination of stable value funds that may be used by a plan. This FAQ also does not discuss or compare other stable value segments such as individually managed or pooled funds or differences in investment management.[ii]

$902 BILLION INVESTED IN STABLE VALUE PRODUCTS[iii]

PRODUCT ALLOCATION AS OF 12/31/20



WHAT IS A STABLE VALUE GUARANTEED INSURANCE ACCOUNT?

Guaranteed insurance accounts are stable value funds that are offered to defined contribution plans such as 401(k), 401(a), 457, 403(b) and some 529 tuition assistance plans, generally managed entirely and guaranteed directly by a single insurance company.[iv] The guaranteed insurance account generally represents the entire stable value investment option.

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.

WHAT ARE THE DIFFERENCES BETWEEN GENERAL ACCOUNTS AND SEPARATE 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) generally 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.[v]

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.

Guaranteed Insurance Account Type	Description	Rate of Return	Assets
General Account	Backed by the assets of the insurer's general account. Can be fixed term or evergreen	Guaranteed regardless of the performance of the underlying assets	Owned by the insurance company Held within an insurer's general account
Separate Account	Backed by assets held in an account separate from the insurer's general account	May be fixed, indexed, reset periodically, or based on the actual performance of the segregated assets	Owned by the insurance company Held in a separate account for the benefit of the plan(s)

Apart from the structural differences, both the general account and separate account contracts are 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.

WHAT ARE THE STRENGTHS OF GUARANTEED INSURANCE ACCOUNTS?

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

GUARANTEED MINIMUM INSURANCE 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.

In addition to the above which are specific to guaranteed insurance contracts, the below benefits apply to all stable value funds:

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.[vi]

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.

WHAT ARE SOME OTHER ASPECTS OF GUARANTEED INSURANCE ACCOUNTS THAT A PLAN SPONSOR SHOULD CONSIDER?

ASSET OWNERSHIP

The stable value fund assets are owned by the insurance company either in the general account or set aside in a separate account for the benefit of the plan(s) in the separate account. This is different than the other stable value segments (pooled funds and individually managed accounts) where the stable value fund assets are directly owned by the participating plan(s).

SINGLE GUARANTOR

The guarantee is backed by a single issuer. This is different than the other stable value segments (pools funds and individually managed accounts) where the guarantee is often diversified across multiple issuers.

DISCLOSURE REQUIREMENTS

Because there are different types of stable value funds and differences in how they are structured, there are also differences in their 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."[vii]

While there are variations, guaranteed insurance accounts 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.

Pooled funds and individually managed accounts 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 funds 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.

FEES/SPREAD

Pooled funds and individually managed accounts disclose an explicit fee that can be easily compared across providers. Guaranteed insurance contracts do not disclose an explicit fee, but rather earn a spread on the underlying assets.

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. 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. 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.

EXIT TERMS

Contract termination options vary depending on the structure of the product but they are always disclosed in the underlying insurance contract. Guaranteed insurance contracts usually have longer termination periods relative to other types of stable value funds (such as pooled funds and individually managed accounts). 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.

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 funds available, and while all stable value funds 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.

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[viii] 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.

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[ix] 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.

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

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

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.

ENDNOTES

i SVIA 2020 Annual Investment & Policy Report

ii For more information about stable value segments other than guaranteed insurance accounts, please see www.stablevalue.org.

iii SVIA 2020 Annual Investment & Policy Report

iv 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.

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

vi 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.

vii 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.

viii 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.

ix 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.