MC Stable Value Audio Transcript

Courtney: Jim, so we have Money Market Reform coming up October 14^{th}, how is that going to impact Stable Value Funds?

James King: [0:00:06] Yes, it's coming, it's amazing how time flies. Money Market Reform has been taking two forms. Basically in 2010 there was the first level of reform where asset quality was required to be increased, duration decreased and liquidity increased. And the second shoe to drop was introduced in 2014, which is now being implemented actually next month. The market is preparing for that. And it should be a positive opportunity for stable value, if you evaluate stable value on both a long term return basis, how stable value performed during the financial crisis, and how stable value has been a long term positive asset class for the Defined Contribution market. I think it's a great opportunity for the asset class.

Karen Chong-Wulff: [0:01:01] So I would echo what Jim is saying, in particular when the reform was, you know, when it was announced. What happened was a lot of the assets came out from prime money market funds to government money market funds. And as a result you see lower rates in government money market funds. So the spread between stable value and government money market funds are even greater from that standpoint. And so that the opportunity is always going to be there for stable value.

Karl Tourville: [0:01:32] Yeah. It's clear it's been a real positive for stable value just from the standpoint of a stable value manager. We've seen really strong new flows in this year into stable value from plans, both new to stable value and those that have existing options with money market funds and stable value where they eliminated a money fund. So it's been … it's been good for the … good for the market.

Warren Howe: [0:01:56] You know, a couple of thoughts there. So at first, you know, from a quantitative perspective there's really been no comparison between stable value and money markets over time. You look at one year periods, three year periods, five year periods, ten year periods, stable value has significantly outperformed this money market. So you know, from that perspective it's always been the right thing. But now because of the Money Market Reform you have this trigger point. And plan sponsors need to take some level of action, whether they choose to stay in a government money market fund or elect to move to stable value. As a fiduciary they're making a decision now. So it's really the right time when you're doing that analysis and you look at it as a 0% yield versus kind of stable value in the 1½-2+ range, really the time is right and stable value is positioned quite well. And I might add it is designed uniquely for the Defined Contribution market. And I think that's a different animal there because money market is really a retail investment, that was not designed for Defined Contribution and stable value is only available and was designed specifically for Defined Contribution plans.

James King: [0:02:57] Yeah. I might also mention too, given what Warren just said about, you know, the spread between stable value and money markets is very attractive. But it's right out above the long term average. And what's really good about the opportunity right now is that if The Fed does start to tighten, even if it's very gradual over time, we'll see interest rates rise not only in the short end, but in the, call it short to intermediate part of the yield curve where stable value is really … it does most of the investing, that's where we put our money. And so those higher rates should produce even more attractive returns for plan participants going forward.

Karl Tourville: [0:03:34] Sure. We see it as an opportunity for advisors and consultants to have value added conversations with their plan sponsors who have money market. And what we're finding is a two pronged process. One has been a switch over to government funds for those clients who aren't ready to move to stable value. And there is an evaluation process going on around money market versus stable value.

Courtney: [0:03:57] And just to contextualize this a little bit, I looked at a 20 year study of comparing money market to stable value. Stable value had a lower standard deviation, higher growth return. So it seems like it's not even just the October 14th impact, but it's over a 20 year period that you could see that.

Warren Howe: [0:04:16] Yes. And that was kind of the point, Courtney, that it's always been the case that it is the more appropriate capital preservation option within a Defined Contribution plan. However, it was somewhat easier in the past for a plan sponsor who had a money market, they weren't required to do anything. So you know, given the choice of doing nothing or making a change, it was easier to do nothing. And at this point you can no longer do nothing. You have to do something. And that is going to be documented and looked back on as to why you chose one over the other. So going through that exercise now, it is kind of that inflection point where somebody needs to take an action. And when you put those characteristics that you've just described out there, it makes stable value clearly the choice.

Karen Chong-Wulff: [0:04:57] Yeah. I think Warren also is referring to the floating NAV aspect of this new reform for money market funds. So you know, before that, it was a constant NAV. So with prime money market funds it's not going to be floating. In addition to that, you know, there is this doing a dire liquidity situation, there's also going to be gates and fees and posts on prime money market funds. And also even for retail money market funds as well.

Warren Howe: [0:05:23] And I do think that people need to understand, and to Jim's point, that changes are going to take place. And this October 14th date is an important date. But by no means is every action that's going to take place happen on or before October 14th. There are a number of plans that understand that if they are going to make a change they need to conduct due diligence as a fiduciary. And they may not be in a position to do that. They may need board approval, and the timeframes kind of start to contract. So we think that there's a huge opportunity before and we've seen it leading up to October 14th. But even funds or plans that go to government funds we think there's still a significant amount that will move to stable value beyond that October 14th date.

James King: [0:06:03] You know, we agree with that and we're seeing that in our own contacts in the market with consultants and plan sponsors. Where we feel a lot of the opportunity for stable value is going to come in 2017 and even 2018.

Courtney: [0:06:17] Well, on that note we actually have a viewer question from a consultant. It's Sean Patton of Westminster Consulting.

Sean Patton: [0:06:27] One of the things that we're addressing with retirement plan fiduciaries right now is how are you as a stable value provider addressing the education needs of participants to help them answer the question, do I invest in a money market, do I invest in a stable value product?

Courtney: [0:06:43] Karen, maybe you could lead that off.

Karen Chong-Wulff: [0:06:44] Sure. I think as an organization our firm has always believed in stable value over money market funds. So it's really no different now with the reform coming up. We don't have a huge percentage in terms of our plan platform allocated to money market funds. That's because we've done the education, you know, for many, many years. So the … I guess, the clients as well as the participants, they get it. You know, they get that this stable value has the higher returns with the same kind of volatility. And now with also the liquidity as well, so it's, to us, you know, it's going on as usual in terms of providing the education to participants that we've always had.

James King: [0:07:23] Yeah. I would say every single firm at this table is a major provider of stable value. And we all have lots of historical research around this whole education of stable value versus money funds. So it's not really something, a new effort for us. We're really just dusting off old research materials and providing them.

Karl Tourville: [0:07:44] Prudential has a record keeper where we are keeping the plan documents and doing the statements and all the work for the plan and its participants. We have very, very few plans with money market funds, and the predominance of stable value. And one of the things that we found challenging about Money Market Reform is the dearth of record keepers that are able to keep track of the fees and the gates. So you have the large money fund providers that are record keeping the prime funds with the fees and gates. But your average record keeper doesn't have the capabilities.

Courtney: [0:08:25] Interesting.

Warren Howe: [0:08:26] So to Sean's point though, the education part of it. There's always been education going on and many times that's the record keeper that provides. Plans are bringing in firms to do investment advice, managed accounts, things of that nature. So there's education coming into the market, consultants who did not pay as much attention to stable value in the past because money market was maybe a bit easier and maybe a bit more mainstream, are now focused on stable value and as such are providing communications. I know each of the firms here are active in market, providing thought leadership materials on stable value versus money market, the benefits of stable value. And I know at MetLife we just recently launched a kind of a grassroots campaign for participants, talking about the differences between money market and stable value, and encouraging them to talk to their plan sponsors about it. So I don't think education will be an issue. There will be a lot of information available.

Courtney: [0:09:16] So it sounds like there's a very robust rollout when it comes to education, even for participants as well, which is great. I want to ask you, and this has been touched on a little bit. What impact will rising rates have on stable value funds, if and when they do raise rates?

Karen Chong-Wulff: [0:09:33] think stable value is designed to produce well, even when rates go down or go up. So in a situation where we think rates are going to go up, because it's been so low for so long. One of the things with stable value is it is in contrast to fixed income bonds. What happens with stable value is because of its design, it is going to rise with interest rates as well, not as fast as money market funds, but it is going to go up. And I think we should be excited that it's going to go up because I don't want to be in a situation in a pro long low interest rate environment where stable value doesn't even beat inflation. So this is kind of a welcome change. And because of the way the product is designed and what we've gone through all these years, I think we are in a really good position, you know, where we have excess reserves here so called, in terms of the market to book value ratio. We have enough reserves for us to be able to cope with higher interest rates as well.

Karl Tourville: [0:10:32] Yeah. We would love to see an increase in interest rate environment. I think we have more risk on the downside of a low interest rate environment than we do in increasing rates. And as Karen said stable value funds will increase or decrease with the market, but at a slightly slower rate.

Warren Howe: [0:10:47] Yeah. And I think it's important to understand, especially when you kind of look at what are the capital preservation options, and what's going to happen with interest rates. So to Karen's point, if interest rates start to rise, money market rates will rise as well. But there's a significant cushion between the returns of a stable value fund and money market. So if you get an orderly increase in rates, you know, 25 here, 25 there, rates start to move, stable value has got a large cushion already. So it will continue to kind of move up as well. The other thing about money market funds is many of the money market funds waived their fees during kind of the financial crisis, and while yields have been zero. So if rates pop 25 basis points, 50 basis points, that's not all going to come through on a money market fund because they're going to start to reinstate their fees. So they will not get that exact pick up. And lastly, when I think about stable value, while rates rise and it has this inverse reaction to the bond market, it's part of a Defined Contribution plan. There are regular flows of contributions from participants. And as those flows come in, they get reinvested as rates are moving up. So you know, there's always been a concern about stable value in a rising rate, but I think it's a bit muted by all of that.

James King: [0:11:52] Yeah. I would say too, agree with everything everyone has said here around it, rising rates clearly will benefit stable value. To Karen's point, which I think is interesting, which is right now the average stable fund has a yield somewhere around call it 1½-2%, which is running right at about the rate of inflation. So I think if we could get rates, The Fed could move rates up one or two times you would see the short to intermediate part of the yield curve respond very favorably. And if we got rates up another say 50-100 basis points it would begin to provide a better premium above inflation.

Courtney: [0:12:30] So tightened credit would be good, not only for stable value as well as the saver, the participants that you're serving as well.

Karen Chong-Wulff: [0:12:37] And to that point, I mean if rates go up or the returns for stable value go up, you know, then it's going to entice, you know, the participants who also stay in stable value versus trying to chase riskier assets, which may not be the right, you know, decision, you know, at this point.

James King: [0:12:53] Yeah. And I'd just comment more broadly on asset classes and stable value, 2% may not sound like, you know a lot of money to be generating for retirement. But most models today on the stock side are anywhere from, expected returns of 4-6%, significantly below where they've been historically. Bonds at yields, you know, 10 year treasury, you know, 1.70 right now. As interest rates start to rise we know bond prices are going to go down. So stable value, will, to the extent that it rises, it has an increase in yield, no principal preservation downside. It's going to be very attractive.

Courtney: [0:13:33] And how have we seen the structure of stable value funds change since 2008?

Karl Tourville: [0:13:40] Well, the financial crisis brought a lot of attention to the asset class. And the … the way the stable market is set up, about 400 billion of the 800 billion is in product that uses wrap. And it's usually multi wrap with banks and insurance companies providing that wrap. In 2008 the market was probably two-thirds bank, one-third insurance companies. And what happened is during the financial crisis, banks looked at … banks looked at the pricing of stable value wrap sort of as a deep out of the money put, remember we had been in a 30 year decline in interest rates and it was viewed. And the pricing was right for that environment. When the financial crisis hit and market to book ratios declined, then banks reevaluated their model. And now the way the market is structured in terms of wrap is now about a third banks and two-thirds insurance companies, so there were significant changes.

Karen Chong-Wulff: [0:14:43] I would also say that it was kind of a different environment then in 2008 where the portfolios, even though we had wraps in annualized securities backing the portfolios, these portfolios for certain managers, they were somewhat concentrated. And so they were really kind of impacted by the financial crisis. It's kind of like going back even before 2008, there were this traditional [inaudible] for stable value. And everybody was worried about credit risk. And so when certain insurance companies went under, there was this big concern and push to diversify. And then we had synthetic [inaudible] and we had the underlying securities. And everybody felt comfortable with that. It's kind of like the pendulum swinging from left and then to right. And then again during the crisis period what happened was some of these securities were overly concentrated. The guidelines were overly lax and the fees were terribly low. And as a combination of that it didn't really help the industry. So the crisis happened and everybody kind of had a wake-up call on that and things have changed since then. The pendulum went to the left again and now it's probably more to the middle which is a great opportunity for stable value to innovate and provide other returns, especially when rates going up.

James King: [0:16:01] I would say from our standpoint, the financial crisis was certainly not a fun thing to go through. As pertains to stable value there were difficulties. But I think the crisis really drove two things, both that have been mentioned, that are real positives for the industry. Number one was the exit for the most part of the banks as wrap providers. And the reemergence of firms like Prudential and MetLife as major players in the wrap market, in the insurance market. The insurance industry designed this product back in the 70s. They've always been comfortable with it and basically got priced out of it by the banks. So, more pricing power as a result of the crisis brought back in a better long term fit for this particular business. To Karen's point, some of the underlying asset portfolios were being managed perhaps too aggressively, more aggressively than they should have, given that principal preservation nature of the asset class. So we have also seen tighter guidelines than were the case before the crash. So as I sit here with almost 30 years in the stable value business, I can say I don't feel like the industry's ever been healthier than it is today. We've got robust issuers, high credit quality, strong credit [inaudible].

Warren Howe: [0:17:22] And with respect to the investment guidelines, there certainly was a bit of a change. But I would say it was more of a specificity in clarification than too much of a structural change. Certainly there were concentration of assets that may be needed to be downscaled a little bit. But I think the way that the guidelines are structured now, where it is much more specific. What used to be a one page document may now be an eight page document. But that's for everybody's benefit. It's to make sure that the plan sponsor and the wrap provider and the investment manager all clearly understand what risks are intended to be taken, and that this is what they can do within these guidelines, so it takes out any uncertainties.

Karl Tourville: [0:18:01] Stable value performed well through the financial crisis. We did have some rebuilding, but the next financial crisis, stable value will do even better and be even a stronger asset class.

Courtney: [0:18:13] You know, is this because of the striking difference between credit quality in 2008 versus now, that it's been so cleaned up or other factors?

Warren Howe: [0:18:21] And I wouldn't necessary say that it's been cleaned up. I mean there was the transformation of the wrap providers who was providing the wraps and the guarantees and the changes and the guidelines. But to Jim's point and I think Karl and Karen made it as well, you know, stable value performed very well through the financial crisis. It did exactly what it was designed to do, participants did not lose their book value. While rates in the market was going crazy, participants got that guaranteed value and it continued to grow based on the credit and rate formula. So no one was without book value coverage and all participants were kind of immune to what was happening in the market.

Karl Tourville: [0:18:55] And I might just elaborate too. I think that there has been, since the crisis, a greater focus on risk management throughout the industry both at the issuer level, the manager level, there has also been even better disclosure than ever. And some of that has to do with some regs that have come into place. But many plan sponsors and consultants have taken a more active role in really deep diving into the intricacies of stable value. And that's been very good for the industry as a whole.

Courtney: [0:19:27] And, Karl, can you dig a little bit deeper, when you're evaluating risks in stable value, how has that changed?

Karl Tourville: [0:19:34] I don't think that our framework for evaluating risk has changed. I mean when you really think about a stable value portfolio, where are the risks? There's really three that would immediately come to mind. One is the credit worthiness of the wrap provider. We've been doing this for, you know, I've been doing this for 30 years. We look at the same things with respect to insurance companies and the bank issuers in the market. There's the risk of the underlying portfolio and the underlying holdings in the portfolio which hasn't really been a change. There's contractual term risk. And I think that this is an area to be addressing. And Jim and Warren starts on this. But I think the actual contractual terms have been more understood better today than they've ever been. And there's really a focus from a legal perspective on all parties to getting it right. And Warren's word that he mentioned earlier, which I completely agree with is the increase in specificity which I think has been very good.

James King: [0:20:34] Yeah. And the other thing that happened is banks had one way of looking at risks and insurance companies take a slightly different look at risk. Where from an actuarial standpoint, if something can happen it will happen, it's just a probability. And that's part of what led to the more comprehensive cohesive risk infrastructure that we've built around the product line. So the foundation of stable value is now stronger than it's ever been.

Warren Howe: [0:21:04] And people need to kind of understand, stable value is not some total return strategy that you're reaching for the stars in return. It is meant to be the capital preservation option with a reasonable rate of return in the Defined Contribution plan. So as everybody understands that it has real expectations as to what that should be. I think when you look at the guidelines and you look at the contract terms and you look at the performance of stable value, it's doing exactly what it should do.

Courtney: [0:21:28] And even in context, I mean even though its purpose is capital preservation, if you compare the interest rates, we've talked about that earlier, to the negative and zero interest rate policy we have outside of the US, 2% is looking very, very good.

Warren Howe: [0:21:42] Especially for people that are kind of at or near or in retirement, and they have not an ability to have the volatility that they could experience otherwise. So you see kind of that utilization for people. And I would go back to the crisis, that was the most important thing, that if you were about to retire and you were not in stable value and you had, your retirement money is subject to those losses that occurred in the market value asset classes. And that was a real impact. So that was the other part of the crisis as well. So there was a flood into stable value funds at that time for people seeking safety. And again it did exactly what it was. It was a safe haven during stressful times.

James King: [0:22:20] Yeah. And I might make a point too around retirement. And I think one of the big benefits of stable value in 401(k) plans is to the extent that they allow their plan participants to remain in the plan after retirement. Where are you going to go out and find a yield of 2%? You know, not at banks, CD or money market funds. So it's an even really attractive product for those in retirement.

Karen Chong-Wulff: [0:22:44] I might add too, that we talk a lot about target date funds and its growth as well, right. And there's not a lot of stable value in target date funds, to the extent that, you know, what happened in the crisis. And there was target date funds then, if you were near retirement you know, it's not 100% stable value. So can you imagine, you're sitting there and you're looking at your funds, and your values go down, you know, let's say 30%. And you may have a slug of equities in there, so say 20% and then 80% in more conservative assets. You still lost money. And say you're already at retirement, near retirement or entering retirement age, it is an asset class that will give you that peace of mind, a sleep at night money that will help you to be more comfortable. So that what you have, you want to preserve the rest then you can go into more risky assets.

Courtney: [0:23:35] And let's take a little bit with target date funds. You know, Warren, why should plan sponsors consider stable value as the fixed income component of a custom target date fund?

Warren Howe: [0:23:47] And it's interesting because post financial crisis, immediately you look at PPA, you look at target date funds, being a QDIA, the asset growth was and really still is going to target date funds. Then you start to think about, okay, what can we do? And what's the fiduciary role as a plan sponsor? Many of them are choosing the off the shelf target date series available from the record keeper. But what doesn't that give them? Doesn't give them control and it doesn't give them flexibility. And if you look at some of the trends in market now, the percentage of plan sponsors moving from kind of off the shelf to custom, it's doubled over the last two years. So if you look at consultants, they're starting to recommend custom target date funds. So if you're a plan sponsor and you have an off the shelf target date fund and you're unsatisfied with the performance of say the large cap manager. Well, you really have no control or flexibility. There's nothing you can do. But if you use the existing investment options that you've selected, that you've done your due diligence on, and then have someone create a glide path that can even be customized to your demographics, for your employees. And build that, you have the flexibility to make changes where needed, and you have the control.

Karl Tourville: [0:24:55] I might add too just from the standpoint of looking at it from an efficient portfolio model with target date funds. To the extent that you mentioned earlier, stable value over time has had even lower volatility as measured by standard deviation in a money fund. It's very attractive to look at a custom target date fund and plug in stable value in place of say a bond fund or in place of a money fund. You know, get higher returns with lower volatility which could either, you could embed that in the product or you could use it as a way to increase risk by having greater allocation to stocks.

James King: [0:25:30] Yeah. So you're always going to have a sleeve of your target date fund with positive alpha and decreasing your risk as well, so it's pretty much a win/win.

Warren Howe: [0:25:40] Which speaks to the customization aspect because now you can customize a glide path to take advantage of either kind of the low volatility where you've got the fixed income component locked down, you know what you're going to get. And don't have to worry about downside risk. Or say, "Listen, because of that we're going to take a higher equity exposure than an off the shelf fund may take because we have this in place." So it is really for a win/win for plan sponsors and participants.

James King: [0:26:03] And as you said, Warren, if you're a fiduciary, either a consultant or a plan sponsor making a decision around a fund line up, including stable value, it simplifies your due diligence process going forward without the complications of another asset class.

Warren Howe: [0:26:17] I mean the DOL has held that, just a selection of a target date fund, your due diligence requirements do not end at that point. So you have this ongoing due diligence requirement as a plan sponsor. So if you're going to have it, why not have it over what you have more control over which are the options that you've selected for the plan.

Courtney: [0:26:33] So with this, and you mentioned all these assets flowing into custom target date funds versus off the shelf. Are we seeing the implementation of stable value now or it's more anticipated that they'll tick up as this trend continues?

Karl Tourville: [0:26:47] I would just throw out just from our own customer base, where we have clients, say half … I'm going to say a third to a half of our clients that we manage stable value for on a separate account basis have got custom target date funds. In all but one instance, they used our stable value, their stable value option within the target date fund.

Courtney: [0:27:10] Interesting. And Jim shared with me earlier some data from ICI that as of Q1 of 2016, target date funds within DC plans accounted for 525 billion, stable value accounted for about 800 billion. So there still is, you know, a big…

James King: [0:27:27] But that stat I gave you doesn't include collective trust target date funds. So if you look at the total, and this was my mistake, it's about 800 billion, in stable value funds it's about 750/775 in target date funds.

Courtney: [0:27:39] So it is edging up closely.

James King: [0:27:42] Yes, it is edging up, yes.

Courtney: [0:27:43] So this begs the question, where do we see growth in stable value coming from?

Karl Tourville: [0:27:48] I think target date funds. And I think, you know, within our client base we've drilled down into what are the holdings in stable value within those custom target date funds. On average we find that 7½-8% of the assets in that target date fund are in stable value.

Karen Chong-Wulff: [0:28:05] And then to the extent that, you know, a lot of the funds are moving from mutual funds to CITs, I think to an extent it gives stable value an opportunity as well, to participate in target date funds. Because you haven't seen as many CIT target date funds, and that growth, you know, is also moving up as well. So there's a great opportunity for stable value.

Courtney: [0:28:27] And to circle back with money market, Karen, do you think that the growth in stable value will come at the expense of money market funds, is that where it's going siphon out of?

Karen Chong-Wulff: [0:28:37] It definitely seems to be pointing to that direction, I mean it's … I mean I would think that consensus, yeah, yeah, definitely.

James King: [0:28:42] Yes, it will come from there, and … but to the extent that short term bond funds or also parts of these target date funds or custom target date funds. I think that the move where stable value is being incorporated is not just for the money market fund, but it's for kind of that short duration bond component as well. So the combination of those two are going to be replaced with stable value. And if you think of all the flows that are going into target dates, whether it be as the default option or people just electing it, it's significant growth. So to the extent stable value can now be a part of that, and an increasing part in these target date series as people, you know, get closer to retirement, it's a significant growth opportunity, not just one growth opportunity, but a significant one for the asset class.

Courtney: [0:29:24] So as of now they are or not a default option in DC plans?

James King: [0:29:28] They are not a default.

Warren Howe: [0:29:29] Stable value funds are not.

Courtney: [0:29:31] So how has affected the stable value market and then the growth trajectory?

Karl Tourville: [0:29:37] Well, before the Pension Protection Act set up the DOL, serving out the QDIA regs, stable value was the default choice when there was one. So in that sense it did take assets away from the asset class. However, in the preamble to those regs, the Department of Labor said that stable value could be part of a qualified default investment alternative product. So that's where target date funds, stable value being part of that, also in spite of that stable value not getting the Safe Harbor treatment for QDIA, the asset class still grew in 2008 from about 540 billion to currently around 800. So that's a 50% increase in spite of not being a QDIA. So it may have had some drag on the asset class. But it speaks to the resiliency of stable value and its appeal.

Courtney: [0:30:33] Yeah. And you touched on this, Jim, but you know, we're about 10 years out anniversary from the PPA - Pension Protection Act. What impact do you think that's had broadly, I know you touched on it, on the stable value funds, and where do you see the next, you know, 20 years, or do you see that changing?

James King: [0:30:51] In terms of its impact on stable value, again a resilient asset class that has proven that regardless of having headwinds in its face it still attracts assets in an asset allocation. In terms of the ramifications going forward, I think the asset class is here to stay. It has the appeal that will make it continue to grow.

Karen Chong-Wulff: [0:31:14] And also since PPA there's been a lot of conversions from DB plans to DC plans. And that definitely creates more opportunity for stable value and [inaudible] more on the retirement plan side of things. So I think there's great opportunity there and I think not only in this country, I think internationally, you see that trend in other countries like Canada and the UK where there is conversion from pension plans to Defined Contribution plans. So I feel like there's a lot of opportunity out there, maybe it's not quite now here but it's something to keep in mind, whether it's 10/20 years time. And I think the key here too is working with each other. We all work together as providers and managers. And trying to create new products and creative solutions to be able to provide this very attractive feature where we have this conservative asset class with a capital preservation feature.

Karl Tourville: [0:32:11] And I would say, I think that how it does is relative. And you know, we do have strong demographic trends, you know, working with this bubble of folks that are going to be retiring, the baby boom generation. So the core cash flows are out, you know, because people are withdrawing money to fund their retirement. That said there is a big millennial population coming up that may be a little bit more thrifty. We've seen basically a C change in investor attitudes toward risk, still eight years beyond the financial crisis. So you know, I think it'll net/net, Jim said, it's here to stay. But is there a lot of growth overall in asset management globally even, not just the United States? No, there's not.

Warren Howe: [0:33:01] A couple of thoughts though, a kind of growth. So how is this pie going to get bigger for stable value? So we talk about custom target dates. Another component is 529. The 529 college savings plan market is growing. It's growing rapidly. It's, what is it, about 20 years old now? So it's developed, assets have been coming in. If you think about the sponsors of those plans, money market has built up an asset base. And we're seeing interest in converting those money market assets into stable value. So you have a growing 529 market. One of the things we've been looking at recently are kind of these new state sponsored Defined Contribution plans. So these are new plans for people not covered under other plans. So to the extent these states adopt stable value, there's inflows there. And then one other interesting aspect that we've been looking at in MetLife is the DOL fiduciary rule. So if you have this additional fiduciary burden on the financial advisors who tend to recommend that people roll out of their retirement plan into an IRA that they manage. If they're more concerned with the fiduciary duty on that recommendation, especially to an IRA where there's higher fees, transaction costs, all of which you don't have in a Defined Contribution plan, we're convinced that a significant amount of dollars are going to remain in Defined Contribution plans. And that tends to be the older people and they tend to invest in stable value.

Courtney: [0:34:20] It's a really interesting point about DOL. Something else interesting, and Karl, you touched on it, the demographic trends. And we have some more ICI data, they did a survey of households that said, to everyone's point, the risk spectrum, when people look at it, 47% of all US households say they want either low risk or no risk. That's almost half of all US households. And thank you for that information, Jim. You know, that seems to just keep pointing back to stable value which has an extremely low standard deviation, especially when you compare it with money market, which people think of as very low standard deviation. This seems like another great tailwind for stable value.

James King: [0:35:01] I think if you look at the broader financial markets you would say that risk is more asymmetric now. If you were to ask anyone, "What are the expected returns on bonds and stocks?" You'd say anywhere from 2-6%. If you asked those same strategists, what is the downside? The downside is going to be 20 or 30%, just based on where valuations are in stocks, the fact that bonds don't have any real room to appreciate, given how low rates are. So that clearly makes the asset class even more attractive.

Karen Chong-Wulff: [0:35:31] So you know, this thing about what Jim said about growth in stable value over the past 10 years, I mean we were also during the 10 years had a lot of, you know, I guess, volatility in the markets. So every time you have volatility and there's this fear factor that comes in, right, everybody jumps to the conservative asset class and stable value really is a beneficiary when that happens. Sometimes it flows out. But depending on your plans, you know, like our plans in ICMA-RC, you know, it's pretty sticky, people coming in, they don't go out at all. And mostly people are conservative as well. So during crisis you can count on stable value, you know, to be there for you, so.

Karl Tourville: [0:36:09] Yeah, I'd be interested in Warren and Jim's experience on this. But you know, we found that monies that flowed into us during the crisis had been, to use Karen's word, very sticky. So that money that came in during that year or two time period, has not quickly gone back out to more aggressive classes as the market's recovered.

James King: [0:36:27] No, it has not, it comes in and it tends to stay. There are some outflows when equity markets rally. But for the most part if we get a 100 flowing in, in distressed markets, maybe 20 flows out when the market goes in the other direction. But stable value money is very sticky on that side.

Courtney: [0:36:48] And it's very possible, I mean we're in the longest equity bull market I think in a very long time, the 30 year bond market run is, you know, going to come to an end. So we could see another dislocation where there could be another huge inflow into stable value.

Karl Tourville: [0:37:04] Another very, it's probably a long shot at this point in time, but seeing what's going on in the marketplace in general where DC plans and IRA plans are starting to be thought about. We should really regulate this money the same way. Currently stable value is not available in IRA plans. The DC market is 6.8 trillion; the IRA market is 7.4 trillion, which would more than double the footprint if we were able to get stable value into that market. It's different risk parameters, there would be some regulatory and structural changes needed. But that's a huge opportunity for the asset class that I am optimistic about.

James King: [0:37:51] Well you guys can use all your lobbying clout for the insurance industry to get that done, okay.

Courtney: [0:37:57] Alright. Well, let's talk about the role that stable value plays within DC plans and with plan sponsors. Karen, what role do they play with other investments within a DC plan?

Karen Chong-Wulff: [0:38:08] So with stable value being the conservative asset class, we've talked about this, and it is the one where you get your constant book value. I mean it's the book value plus accrued interest. I mean it's a conservative rule where you can use stable value with other more risk assets. So there is always a need for that. And also it could be … we talk about this too in terms of target date funds, or it could be the conservative component of a target date fund. And there is always a need for, you know, I can't stress this enough in terms of there's always a need for this conservative asset class. And just because somebody is going to retire one day and somebody is going to want to come on this part of the portfolio. And if you look at Defined Benefit plans, there's always a component of fixed income, the conservative piece. So it's no different. It's different in a sense because it's not a DB plan. But there is a need for this stable value too for a DC plan.

Courtney: [0:39:08] Warren, so I mean Karen kind of laid it out that this is the capital preservation part of the portfolio. But when people are choosing that capital preservation part, why would they choose stable value over other capital preservation vehicles?

Warren Howe: [0:39:21] Well, there's really just a few capital preservation vehicles if you think about it. There are stable value, money market has been kind of the prime competitor if you will, as the other capital and to an extent you see these FDIC insured structures that are in the market. So when you kind of think about all of those together from a quantitative perspective, the returns on stable value are significantly above what any other capital preservation option can provide. And it's not just about the returns, but the returns are important, understanding that there is a guarantee around those returns as well. So what you're going to get is you're going to get more of an intermediate term bond focus as opposed to a short end of the market focus. And you're still going to get that principal preservation at all times, so it's clearly better.

James King: [0:40:04] Yeah. And if you put it in perspective, asset managers scratch and claw for every basis points of additional return that they can get. And to offer an asset class that provides on average, as Karl said, about 150 basis points of additional return, it's hard not to go there.

Courtney: [0:40:21] Yeah. That's not insignificant, especially when, you know, we see across the board, people chasing yield with very high risk assets. So for the amount of risk you're taking on it's a very significant return profile. So what about diversification though, how does that all play in together with stable value, Warren?

Warren Howe: [0:40:39] Well, there's several ways to look at diversification. And when you think about just investing in general, diversification makes sense. Now, you can diversify by a wrap provider in a portfolio and have your credit risk and at least issuer risk, diversified. You can diversify it by underlying investment manager and get different styles of investment management so you're kind of blending them together and not completely dependent upon one investment manager and their performance. So you kind of diversify out that way. So you can diversify it by structures, participating structures versus non-participating structures to hedge against interest rates going in either direction. So there's lots of ways to diversify within stable value. And I would say to a degree, all of them make sense in some respect.

Courtney: [0:41:24] Okay. And I just have one more viewer question from Sean Patton of Westminster Consulting. It is about transparency on fees.

Sean Patton: [0:41:38] One of the conversations that we have with retirement plan fiduciaries when it comes to standard value is the lack of transparency on fees and the crediting rate. What would you say to the plan sponsor that asks that question?

Courtney: [0:41:50] Jim, your thoughts?

James King: [0:41:51] Okay. Credit and rates are very transparent. There are products that set a daily crediting rate. There are insurance products that set a rate in advance guaranteed for a certain period of time. Transparency for the pooled products, for the collective trust tend to be more transparent as it relates to fees, fees are fully disclosed. There are some general account insurance products that are called fixed rate products where the Department of Labor define them as having an interest rate set in advance, guaranteed for a certain period of time where the risk is borne by someone other than the participants. Those are called spread products. So the spread that the insurance company makes, the difference between the asset, yield and what they pay out is not known. But those products also guarantee a rate in advance, set it for a set period of time and also provide a non-zero return. So insurance products are a little different than the rest of the marketplace, and it's all about choice. And you know Karen and Karl have great funds. And maybe you could…

Karen Chong-Wulff: [0:43:07] And it is a question of looking deeper, it may look opaque. Like some people say it's opaque in terms of our fees. But really it's all there in our disclosure. I know we disclose everything in our fund factsheet. And it is a matter of asking the questions and for us we try to disclose as much as possible. And so there's a question of just asking the questions and working with us and we'll tell you as much as we can, and we just really open up the books to show you how we determine the crediting rate.

Karl Tourville: [0:43:36] Yeah. I think with respect to transparency, a lot of positive things have happened over the years. And certainly there's some very tight disclosure requirements that we as investment managers have to follow, that we disclose around fees as Karen mentioned. Every fee that we charge or we levy as a manager needs to be disclosed to our customers. And any time there's a change in that we are required to report that as well. So I would say that I think stable value is a very transparent product with respect to fees.

Warren Howe: [0:44:12] Yeah. The vast majority of the market is in kind of these collective trust structures that are in the market. And if you look at a collective trust fund or if you look at an insurance company, separate account, very clear, these are the fees and the crediting rate formula is formulaic. So it's very clear as to what the inputs are and how that crediting rate is derived. To Jim's point on the insurance side, it's all about choice for the plan sponsor. Whether it's important to see those inputs and see what the yield is versus kind of what tends to be a longer duration general account type of structure where they're truly passing off the entirety of the risk to the insurance company. So, yes, there is a spread, if the insurance company gets it right. But there is also a downfall if they get it wrong. And they are always on the hook for that, no matter which way it goes. So it's a question, participating versus kind of a non-participating structure.

Courtney: [0:44:56] And the point is that it's all delineated and your documents, it's extremely transparent. It's a matter of just reading through the offering documents, right?

Karl Tourville: [0:45:05] And in many cases sitting down with your customers, reviewing those documents.

Courtney: [0:45:11] Yeah. It seems like there's a great willingness to provide both education as well as information about fees. Let's talk about the future of the industry and trends that we're seeing. You know, just let's dig down a little bit deeper, but just broadly what are you seeing in terms of trends in the industry. And let's start off with you Karl?

Karl Tourville: [0:45:31] I think trends in the industry, many of which we've already talked about here on the panel here today. But you know, clearly the evolving importance of target date funds and specifically custom target date funds that use collective funds versus off the shelf mutual fund related products that have inherently more fees and therefore are less efficient. I think that that's one major trend. Obviously the demographic headwinds of the industry with respect to this big group of folks that are retiring now is another. But beyond a couple of instances, I think the product is by and large as it always has been, you know. And we do have opportunities in newer markets that we reference. But the beauty of the product is the simplicity of it. And I think that will continue to bode well for its success going forward.

Courtney: [0:46:27] Yeah. And, Karen, what challenges do you see is facing stable value funds?

Karen Chong-Wulff: [0:46:31] Well, I think in terms of challenges, I mean obviously the low interest rate environment is a challenge, I would think so. But I don't think it's going to be low forever. It has been low for a long time but I think it's gradually going to go up. So I would mitigate that. I think that in terms of the QDIA, in terms of target date funds to the extent that they remain in a mutual fund product, it's difficult for stable value to be part of that. So I think the move to CITs will be a very big help in terms of this. So I think those are some of the main challenges. And of course, you know, if there's a hiccup in the industry, you know, within the stable value industry then, you know, that's not a … it doesn't go well for the industry as well. But you know, like we said earlier on, I think the industry has gone through the paces in terms of some of the risks that were there before. And a lot of people are more conscious, you know, to manage risks better. We're more conscious of risks. We work with [inaudible] a lot. And I think that really mitigates a lot of those kinds of risks as well. So we're really in a good position going forward.

Courtney: [0:47:32] Yeah. It seems like a very collaborative industry, which is nice to see, Warren, any other trends or the future of stable value that you're seeing?

Warren Howe: [0:47:39] I think to Karl's point, that the beauty of stable value is it is what it is and it's more about the growth markets, and it's expanding the footprint. It's growing within the Defined Contribution market. It's getting in as part of custom target date funds. It's potentially creating a CIT version where it's kind of available on a more off the shelf basis, that would be out there. It's this DOL fiduciary rule market. It's ways to kind of expand the footprint that are there. And to Karen's point about the interest rate environment, or that you're concerned about the interest rate environment and prolonged low rate environment. But it's all about too, what it's competing against. And if rates do stay low, while it is a challenge to manage the portfolio, it's competing for dollars against other similar vehicles. And if they're low as well and you still have this built in advantage, it's going to be good, so growth, that's the trend.

Karl Tourville: [0:48:33] And you hit the nail right on the head, Courtney. This industry is very collaborative. We have a bunch of great professionals who are very dedicated to the asset class. And we spent probably 2009 through 2012 reworking the foundation of the asset class. Now we have the opportunity to do the product development, to take a look at the … and put the resources in to custom target date funds into the 529 market, into foreign markets, into potentially cracking the IRA. I have a very positive viewpoint on the asset class. And I think it's going to continue to grow.

Courtney: [0:49:10] Alright. Well, on that note I'd love to get everyone's final thoughts, and I'll start with you Warren.

Warren Howe: [0:49:14] I think stable value is in the best position it's ever been in. We continue to see growth in the asset class. It's doing exactly what it's supposed to do. There are all the opportunities that we've mentioned for the ability to grow the asset class in other markets. But even just in the Defined Contribution market itself, it's Money Market Reform. It's educating people about the availability of it. So I think we're in a wonderful position to provide meaningful guarantees for participants and we continue to do so.

Karl Tourville: [0:49:45] Again, as I mentioned earlier, I think this industry has never been stronger. It's an industry that has continued to reinvent itself over time. There have been many challenges to the product when you look back to the late 80s, the mid 90s and even into this past, you know, 16 years. Each time the industry has come together and put … and maintained, you know, a very collaborative approach and developed positive solutions. So to the extent that that's the fundamental and that's the way the industry's always worked, we see good things going forward.

Karen Chong-Wulff: [0:50:22] I go a lot of what Karl and Warren just said, but I've been doing this for over 25 years. I am going through the thick and thin of things in terms of this industry in terms of ups and downs. And I think really what it is, is … I mean this is … I think this is a special asset class. It's got the benefits of that capital preservation. It's also got a decent return. And to the extent that people don't understand stable value, I think it really behooves them to take a look, understand [inaudible], and see a little bit in terms of what this really offers, versus saying, "It looks complicated." You don't want to look at it. So I think it really makes sense for us to kind of look at it closer, and it's kind of like, it is what it is, it's not too good to be true, it is true. And it's going to offer and provide that stability, and we build retirement security for funds in our corporation. And it's going to provide that going forward.

Courtney: [0:51:17] Yeah, hopefully programs like this will help eliminate the topic, Karen, Jim, your final thoughts.

James King: [0:51:21] My final thoughts are it's a great industry, it's about the people who are in it, the dedication that is shown to the asset class. I mean you've heard it. Those are all great reasons to be in stable value. And we're here to stay.

Courtney: [0:51:34] Alright. Thanks so much. This has been great. And we want to continue this conversation about stable value. Follow us on our social media, on LinkedIn and Twitter. From our studios in New York I'm Courtney Woodworth.