

NAGDCA 2013 ANNUAL CONFERENCE *Championing Your Retirement!*
SEPTEMBER 10-11, 2013 / LOUISVILLE, KENTUCKY

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Stable Value Funds

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Disclaimer:

This program is aimed at sponsors, trustees, and administrators with fairly advanced knowledge of stable value products and wrap contracts. For basic background, "SV 101" slides are included at the end of this presentation, as well as a glossary.

This presentation is for institutional use only.

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OUTLINE

- I. Value Proposition of SV: comparing SV to alternatives
- II. Wrap Developments
- III. It's Complicated and Requires a Team

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I. THE VALUE PROPOSITION OF STABLE VALUE
 How does SV compare to its alternatives?

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How important is the stable value asset class to investors?

401(k) Plan Asset Allocation
 (Relative size within the Aon Hewitt 401(k) Index)

Source: Aon Hewitt 401(k) Index, as of March 31, 2013. The Aon Hewitt 401(k) Index is considered representative of general 401(k) plan asset allocations.

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Low Volatility Options

- Money Market Funds
- Short/intermediate bond funds
- Stable Value

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Volatility of Monthly Returns

12/31/1988 thru 06/30/2013

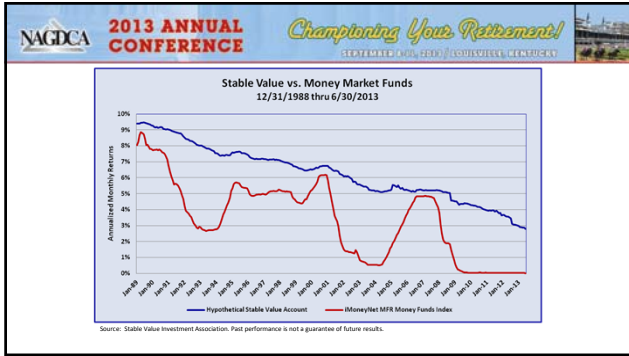
Source: Stable Value Investment Association. Past performance is not a guarantee of future results. The "Hypothetical Stable Value Account" used in slides 8-12 is intended to be a simplified illustration of the impact of spreading market value performance gains and losses over time. For the purpose of these simplified illustrations, the Hypothetical Stable Value Account incorporates use of the Bond Index returns as the underlying investment attached to simulated stable value under contracts. The incorporation of this "wrapper" Bond Index with its use of simplified performance spreading techniques should not be construed as representing any actual or intended Stable Value Account or Stable Value Fund. Moreover, this Hypothetical Stable Value Account is not intended to constitute nor represent a benchmark. This Hypothetical Stable Value Account data and related graphics in relation to the Money/Net MFR Money Funds Index and the Barclays Intermediate Gov/Credit Bond Index is intended solely to simulate the principles of performance amortization techniques and relative levels of yield curves. These materials may be used only with www.stablevalueinvestments.com/Investment/Assets/Assets.htm.

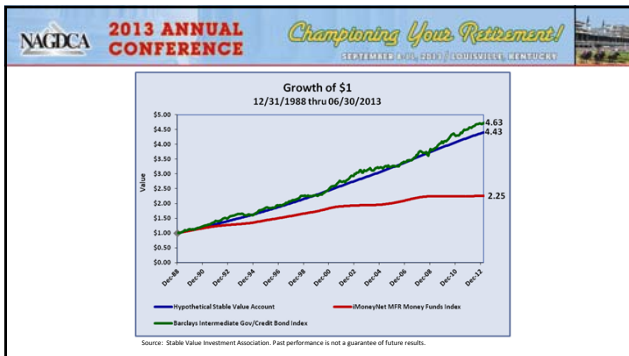
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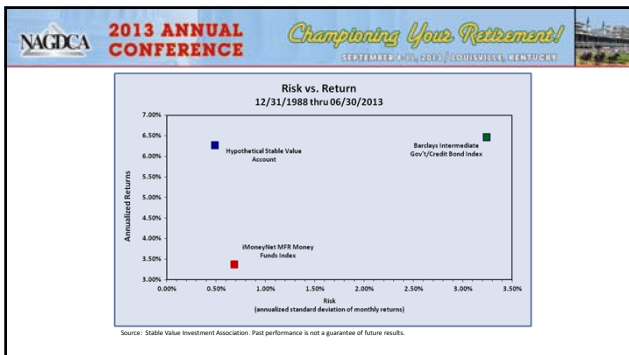
5 Years of Annualized Monthly Returns

6/30/2008 thru 6/30/2013

Source: Stable Value Investment Association. Past performance is not a guarantee of future results.







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Rising Rates: What Happens to Stable Value Returns?

- Portfolios designed to respond to rising (and falling) rates
 - New investment dollars invested at current rates
 - Market return movement averaged into overall SV returns
- **Crediting rate formula**
 - Reflects new current interest rates
 - Amortizes market-to-book gains and losses
 - Convergence objectives
 - Market value = Book value
 - Market yields = Crediting rates
- **Stable Value returns**
 - Designed to track market rate changes ... with a lag
 - Influenced by positive and negative participant cash flows
 - Negative cash flows retard return convergence
 - Positive cash flow enhance return convergence

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Crediting Rates vs. Rising Yields -- ILLUSTRATION

• Hypothetical example designed to illustrate return amortization principles
 • Assumes no ongoing cash flow

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II. Developments in the Wrap Market

- Current state**
- Best Practices**
- Contract and Asset Types**

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Wrap Market Summary as of 6/30/2013

- Guideline constraints are being driven by wrap providers seeking to reduce risk
- Insurance companies continue to gain market share in effort to grow assets under management
- Availability of wrap capacity has been impacted by plan specific underwriting concerns
- Wrap counterparties have increased focus on plan design and competing fund provisions

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Wrap Market Summary as of 6/30/2013 (con.)

- Primary catalysts for wrap market disruption following 2008 crisis were portfolio volatility, regulatory uncertainty, and risk management scrutiny
- Entry of new synthetic wrap counterparties has stabilized wrap market
- Wrap contract issuers are significantly more discerning in terms of plan underwriting and manager selection
- Wrap market is increasingly segmented by contract terms, contract types, and counterparty credit quality
- Wrap fees generally range between 20-30 bps

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What Should Plan Sponsors Focus On?

- Establish open lines of communication with stable value manager and investment consultant. Why?
 - Plan design changes must be carefully managed (re-enrollment, new options, new managed solutions, etc.) – require new underwriting by wrap provider
 - Communications to participants being more heavily scrutinized by wrap provider
 - "Competing options" (money market, SDB, TIPs, bond funds, etc.) may trigger "equity wash" requirements
- Consider underlying portfolio duration and credit risk. Ask the question: Is the portfolio being managed in a sustainable framework in today's more constrained wrap environment?
- Consider wrap contract types. Synthetic GICs vs. Traditional GICs? Evergreen vs. Target Maturity?

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Stable Value Management - Best Practices

ASSET MANAGEMENT GOALS	LIABILITY MITIGATION GOALS
<ul style="list-style-type: none"> High-quality liquid assets Low volatility market-value returns Full transparency of assets Strong wrap counterparties No commingling of stable value and non-stable value assets Comprehensive risk management and reporting capabilities 	<ul style="list-style-type: none"> Manage impact of withdrawals (low liability risk, or "run") Reduce impact of corporate actions/holder/participant outflows Manage pool "put queue" and ability to pay in kind Maintain pool diversification Monitor shifts in liabilities

Investment Objective: Principal preservation with competitive returns over time

Source: Fidelity Investments.

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Guaranteed Investment Contract (GIC) Overview

	Traditional GICs	Separate Account GICs	Synthetic GICs
Ownership	Assets owned by insurance company and commingled in general account	Assets owned by insurance company and walled off in a separate account	Assets owned by plan
Contract Rate	Usually fixed for the term	Reset periodically based on portfolio experience	Reset monthly based on portfolio experience
Diversification	Concentrated in insurance sector	Concentrated in insurance sector but with underlying diversification	Diversified portfolio
Investment Guidelines	Insurance company general account guidelines	Insurance company, sponsor, and manager agreement	Wrap provider, sponsor, and manager agreement
Contract Maturity	Usually fixed term (3 to 5 years)	Open-ended, with termination notice provisions	Open-ended, with termination notice provisions
Termination Provisions	Lesser of book or market value	Market value, or convert to traditional GIC	Market value, or incommensurate to book value
Fees	Insurance company wrap fee and management fee embedded	Asset management fee, insurance company wrap fee	Asset management fee, wrap contract fee

Source: Fidelity Investments.

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Benefits of Synthetic Wrap Contract Structure

- Assets owned directly by plan participants
- Transparent underlying holdings and fees
- Investment guidelines can be customized
- Assets are liquid in the event of counterparty default
- Contract termination provisions are generally more flexible

Source: Fidelity Investments.

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Target Maturity Contract Structure Overview

- Favored by some wrap providers because the risks are more easily managed and hedged
- Challenges for plan sponsors and investment managers:
 - May increase cost due to diminished economies of scale
 - Returns may decline as the portfolio duration declines
 - May have difficulty sourcing replacement capacity when contract expires
- Conclusion: Evergreen contracts are superior structure

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III. It's Complicated and Requires a Team

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Board / Trustee Education

- The ideal is that all committee members are familiar with all investment options within their plan
 - Specialty funds
 - Equity funds
 - Bond funds
 - Capital preservation funds
 - Typically half of plan assets
 - Determine type of investment

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Board / Trustee Education

- Capital preservation funds
 - Stable value funds – it is important for you to understand
 - Your participants (behavior and demographics)
 - Your stable value portfolio
 - Your wrap contracts
 - Your risks

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Things to Consider

- Type of stable value fund
 - Separate account – more flexibility over the portfolio but heightened responsibility
 - Pooled fund – lumped together with other investors

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Leverage Your Stable Value Manager

- Board/Trustee education
 - Portfolio
 - Wrap providers
 - Regulatory, legislative and industry environment
 - Risks
- Participant education

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Trends

- Wrap providers demanding to manage assets
- More and more constraints on portfolios
 - Risk
 - Credit quality
 - Duration
- Changing contract type / what type of assets

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The Role of a Stable Value Consultant

- As an independent advisor to the plan and investment committee, consultant focused on three things
 - Outcomes – building the most appropriate line-ups with the best investment vehicles is crucial
 - Education – we believe an educated committee is more effective
 - Process – as a fiduciary to the plan, I have a responsibility to the plan participants and must follow a prudent process and document that process

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Best Practices

- Board / Trustee education
 - Work with your record keeper
 - Understand your participants and your portfolio
- Leverage manager(s) through training
 - Ask questions
- Consider alternative investments
- Document your prudent process

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The Bottom Line?

Stable value products are complicated. But for principal preservation with lower volatility than the alternatives, nothing has historically served those objectives better than SV. Board / trustees must decide if they can tolerate and manage the complexity in exchange for unique product not available to participants in the retail space.

Past performance is no guarantee of future results.

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STABLE VALUE 101

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Stable Value Investment Objectives

- Protection of principal ← **PRIMARY OBJECTIVE**
- Liquidity at book value
- Once other objectives are met, optimize returns

Stable Value Benefits to Investors

- Day-to-day returns generally higher than money market funds
- Stability of principal balances
- Long-term returns consistent with intermediate bonds

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Stable Value Investment Design

Portfolio of Fixed Income Securities
 Managed by fixed income manager

Insurance or Wrap Contract
 Issued by bank or insurance company

Stable Value Investment

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Stable Value Investment Design

Asset Class	Percentage
Treasury	43.7%
Non-US Govt/Agcy	0.2%
MBS	15.5%
Corporate	14.4%
ABS	10.1%
Cash & Eq.	4.0%
Agency	4.7%
CMBS	7.3%

Insurance or Wrap Contracts

Underlying Fixed Income Portfolio

For illustrative purposes and not reflective of any specific strategy

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Stable Value Glossary

Book Value	<ul style="list-style-type: none"> Principal plus credited interest Made possible by wrap contracts
Market Value	<ul style="list-style-type: none"> Fair value of underlying assets supporting wrap contracts
Wrap Contracts, Insurance Contracts, Group Annuity Contracts	<ul style="list-style-type: none"> Investment contracts issued by bank or insurance companies Guarantees book value liquidity for participants Provides for crediting rates no lower than 0%
Crediting Rates	<ul style="list-style-type: none"> Stated crediting interest rates, reset quarterly or monthly, posted daily to accounts The return that participants see
Market-to-Book (MV/BV) Ratio	<ul style="list-style-type: none"> Relationship of the value of underlying bonds to value of wrap contracts Ratio traditionally varies – say, in a 97% to 103% band – as bond market performance varies

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