
Blue Prairie Group Stable Value Database

Summary of the Findings as of September 30th, 2011

Blue Prairie Group, LLC
November, 2011

The information contained in this summary does not constitute investment, legal, accounting, tax, consulting or other professional advice. Before making any decision or taking any action relating to the issues addressed in this piece please engage a qualified professional advisor.

Table of Contents

- About Blue Prairie Group..... 3**
- Forward..... 4**
- Overview of Data Collection & Methodology..... 5**
- Key Findings from Third Quarter 2011 6**
 - Range of 1-year investment returns 6
 - Range of Durations..... 6
 - Range of Crediting Rates 7
 - Table 1: Stable Value Crediting Rates vs. Duration as of 9/30/11..... 7
 - Portfolio Sector Allocations..... 8
 - Range of Fees 8
 - Investment Guidelines 8
 - Wrap Contract Provisions..... 8
 - Fast Growing Funds..... 8
- Key Questions to Ask Your Stable Value Fund 9**
- Comparison of Stable Value Products 10**
- Glossary of Terms..... 11**

About Blue Prairie Group

Blue Prairie Group is an independent, fee-only investment retirement and investment consulting firm based in Chicago. We work with scores of organizations and individuals across the United States through our three core practice areas:

- ERISA
- Foundations & Endowments
- Wealth Management

We are recognized as one of the premiere retirement and investment consulting firms in the country. Inc. Magazine recently named us one of the fastest growing, privately held companies for two out of the last three years, and Registered Rep Magazine just named Blue Prairie Group as one of the top 50 independent Wealth Manager RIA firms.

Within our ERISA practice area, we specialize in the following areas:

- Fiduciary-based Investment Consulting™ for institutions;
- Stable value consulting;
- Total plan cost analysis and fee negotiation;
- Retirement income products;
- Custom target date fund design and maintenance;

For more information about the firm and its services, please visit the website at www.blueprairiegroup.com.

For more detailed information about the stable value database, please contact:

- Matthew Gnabasik, Managing Director, (312) 376-8435, matt@blueprairiegroup.com

Forward

At Blue Prairie Group, we believe that stable value is one of the most important asset classes in a participant-directed defined contribution retirement plan because of its ability to deliver a “safe” return with significantly lower volatility than a stock or bond fund. Participants seem to agree; today, stable value assets represent about 25% of all defined contribution assets¹ and yet, despite its popularity, stable value continues to be one of the least understood and appreciated asset classes in the defined contribution marketplace.

Blue Prairie’s Investment Analytics Group has been collecting detailed quarterly information from the country’s leading stable value providers for years. Until recently, we’ve used the information collected in our quarterly questionnaires to provide detailed information to our clients as part of our proprietary Fiduciary-based Investing Consulting™ process. However, the incongruity of this situation – one the one hand, a popular investment option in many defined contribution plans and on the other, an investment option poorly understood by plan sponsors and their advisors - prompted Blue Prairie Group to create and make available quarterly highlights from our proprietary stable value database.

Stable value funds require careful attention not only during the initial selection phase, but on an ongoing basis as well. Beginning with this summary and going forward, we will provide updated quarterly stable value summary information on our website. In future summaries, we also expect to include additional tables and graphs showing trend lines based on the different key metrics we monitor. We hope that this information is helpful to you in better understanding your current or prospective stable value product.

¹ As of year-end 2009, participants had invested over \$550 billion in stable value assets. Source: Stable Value Industry Investment Association, “14th Annual Stable Value Investment & Policy Survey,” 2010.

Introduction - Overview of Stable Value Data collection Methodology

Every quarter, Blue Prairie's Investment Analytics Group sends out a detailed questionnaire to 16 leading stable value providers representing \$151 billion of stable value assets. These stable value providers include some of the most well-known fixed income managers and insurance companies working in the stable value sector. In our quarterly questionnaire, we request detailed information on a portfolio's risk characteristics, including duration, sector allocations, crediting rates and cash positions. Most of the data is derived from pooled or commingled funds used by multiple ERISA plans.

Aside from portfolio characteristics, we also request information regarding the wrap provider contracts that guarantee the book value of the portfolio to participants. Providing good information about key wrap contract provisions is a unique feature and important differentiator of the Blue Prairie Group Stable Value Database. Since the credit crisis of 2008 – 2009, the wrap providers have shrunk capacity, raised prices, and materially modified key contract provisions. For those plan sponsors with stable value assets large enough to create their own separate account stable value fund, a thorough understanding of key wrap contract provisions is as important as selecting the fund managers in determining whether the current (or prospective) stable value fund is "competitive". For the many plan sponsors who use a pooled or commingled fund in which the wrap contracts are already built into the fund, we've created a series of questions later in this report to assist in evaluating your current fund.

Key Findings for Third Quarter 2011

Based on the most recent questionnaire responses as of September 30th, 2011, we summarize our key findings below.

Range of 1-year investment returns

- Performance ranged from 1.3 to 4.5 percent.
- Market-to-book ratios generally increased due to falling interest rates, which was a stronger contributor to the ratio than a weaker corporate sector, which depressed bond prices.
- Stable value funds offered by the insurance companies, in either a traditional “guaranteed investment contract” (GIC) or a Separate Account GIC structure, had the highest returns as a result of the underlying portfolios having higher levels of credit risk, duration, or a combination of both.
- Comingled funds with higher crediting rates, and longer durations, also generated better returns. The crediting rate formula is function of the fund’s yield-to-maturity, duration, market value, and book value.

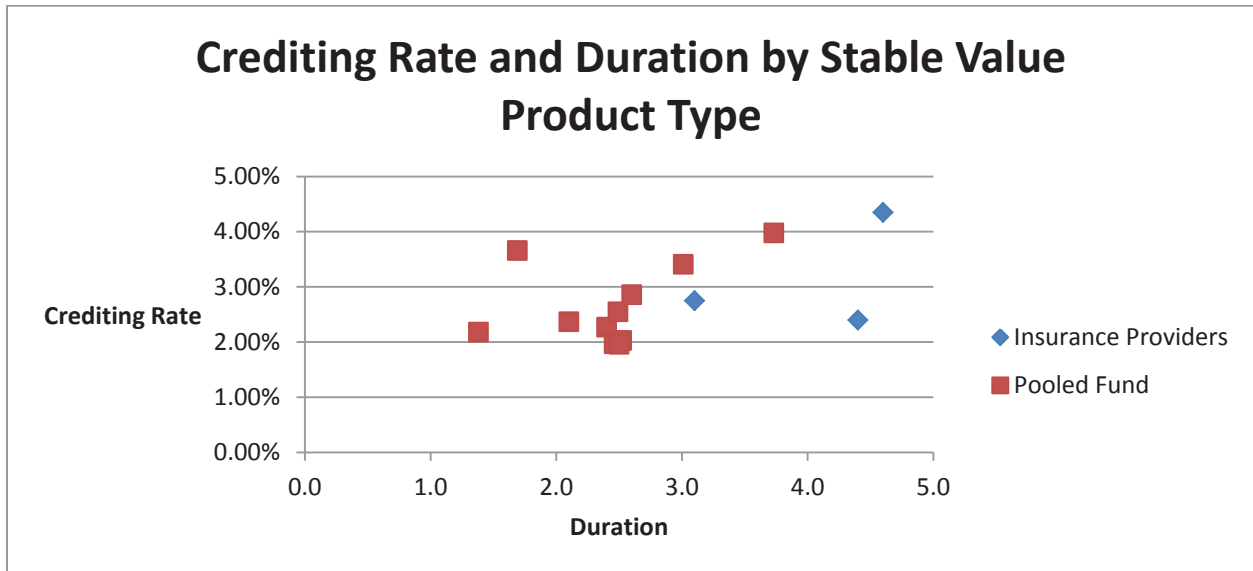
Range of Durations

- Durations ranged from 1.6 to 4.4 years, and have shortened during the year.
- The funds offered by the insurance companies, in either a traditional GIC or a Separate Account GIC structure, had durations greater than 3 years.
- 90% of the commingled funds we track had durations of between 2 and 3 years.

Range of Crediting Rates

- Crediting rates ranged from 1.85% to 4.35 percent.
- Because the traditional GIC-structured stable value funds offered by the insurance companies are part their general account, they can hold longer duration bonds and assume greater levels of credit risk than multi-wrapped funds. As a result, they generally have higher crediting rates.
- Crediting rates are gradually falling, as new contributions are invested at lower current interest rates, and will continue to fall. The fees to wrap new funds are ranging from 15 to 25 basis points, and are equal to the yields on short-term bonds, earning a net yield near zero basis points. Consequently, many fund managers are keeping the funds invested in a money market fund.

Table 1: Stable Value Crediting Rates vs. Duration as of September 30, 2011



For the larger funds in the database, the above scatterplot shows a fund’s crediting rate compared to the duration of the underlying portfolio. Based on the data in the scatterplot, several observations can be made:

- The range of data points suggests that there are real differences between various stable value funds.
- As of September 30th, 2011, there is a positive correlation between duration and crediting rate i.e., portfolios with higher durations generally had higher crediting rates than their peers. In today’s low interest rate environment, extending duration increases the potential for greater volatility and a decline in the market value of the fund if interest rates rise.
- There are significant differences between portfolios with similar durations, leading to the conclusion that stable value portfolio characteristics such as sector allocations, cash holdings, and security selection can lead to real differences in return.
- The insurance companies are, generally speaking, managing portfolios with longer durations, since they rarely use third-party wrap providers to maintain the book value for participants. Instead they “self-insure,” using their own general account assets to guarantee payments and to preserve portfolio book value.

Portfolio Sector Allocations

- Stable value fund managers have generally increased their allocations to government-backed mortgages and high quality corporate bonds.
- Some managers are also increasing their funds' allocations to commercial mortgage-backed and consumer-loan backed bonds as those markets have, to some degree, come back to life after virtually shutting down during the credit crisis of 2008 and 2009.

Range of Fees

- Fund fees range from 10 to 90 basis points.
- Wrap fees range from 15 to 25 basis points, and are included in the fund's total fees.

Investment Guidelines

- Wrap providers have taken steps to reduce their risk to stable fund guarantees, by requiring fund managers to follow conservative investment guidelines than a few years ago.
- The permissible portfolio durations are now shorter for funds with multiple wrappers, with only short or intermediate mandates allowed.
- There are tighter sector limits for corporate and securitized bonds.
- Portfolios are now required to have higher-than-average credit ratings.
- Mortgage-backed and consumer loan-backed bonds are now required to have AAA-ratings from multiple rating agencies.

Wrap Contract Provisions

- Contract terms are more conservative and there is a greater level of specificity.
- The definition of a "competing fund" has expanded from just a money market fund to now include brokerage windows, TIPS, and short-term bond funds.
- There are greater restrictions on allowing stable value managers to include "impaired assets" in the portfolio.
- Portfolios have higher allocations to U.S. Treasury and Agency bonds, as sources of liquidity, in the event of large cash withdrawals.
- Compliance reporting requirements dictated by the wrap providers have increased.

Fastest Growing Funds

- Galliard, Invesco, and Vanguard have had the largest cash inflows into their commingled funds as a percent of their June 30th, 2011 reported total net assets.

Key Questions to Ask Your Stable Value Fund

We created below a series of questions to ask of your current stable value provider. By getting answers to these questions, you should have a good idea of whether your current stable value fund is competitive or not across a number of important product design dimensions.

- What is the fund's current market-to-book value ratio? - During Q3 2011, most pooled stable value funds had a market-to-book ratio higher than 102 percent.
- What is the fund's current crediting rate and how does it compare to the rates paid by other stable value funds, and the yield earned on money market funds? - Generally speaking, longer duration portfolios have higher crediting rates than shorter ones. (Please see the graph on page 6.)
- Which financial institutions are wrapping the fund, or the bonds owned by the fund? What are the most recent credit ratings and outlooks on these companies from the credit rating agencies? This is critically important when evaluating stable value products offered by the insurance companies, for both separate account and general account products, which are "self-insured." - Knowing the financial condition of the underlying wrap providers is an essential step in evaluating the overall risk of the fund.
- Do the book value contracts allow the wrapper to terminate the contract at market value if the plan sponsor or investment manager experiences a change of control of over 50% of the ownership of the entity? – Understanding all contract termination provisions is required as part of a thorough stable value fund due diligence process.
- If the plan sponsor decides to terminate a plan's investment in a stable value fund, how much time must pass before all the participants can receive their funds at book value? What other termination provisions exist?
- What are the high-level risk characteristics of the underlying fixed income portfolio? – In the case of conservative fixed income portfolios, knowing how the managers generated a fund's past performance, and how the portfolio is invested today, can provide some insight into how the fund will perform in the future.

- What are the fund's investment guidelines for the appropriate levels of interest rate risk (duration), and credit risk for the fixed income portfolio?

- Who is/are the underlying fixed income portfolio manager(s)? – Sometimes a stable value fund will have multiple sub-advisors and/or have recently changed its manager. Plan sponsors should select fund managers with a large, dedicated stable value team.

- What are the fund's fees? – Fees vary not only between the products offered by different firms, but can also vary within one firm's stable value products. Many pooled funds have multiple share classes designed to provide different levels of revenue sharing to the record keeper.

Comparison of Stable Value Products

The table below provides an overview of the three main stable value structures offered to plan sponsors.

	Insurance Company Separate Account SV Funds	Synthetic Guaranteed Investment Contract SV Fund	Pooled Stable Value Funds with Multiple Wrappers
Who holds legal title to the assets?	Insurer's separate account	Plan sponsor	Pooled fund manager
What type of principal protection is offered?	If structured properly, the participant's principal is protected against market value risk and credit risk.	If structured properly, participant's principal is protected against market value risk and credit risk.	May protect against market value risk, typically do not guarantee return of principal for defaulted securities.
What type of crediting rate guarantee is typically offered?	Minimum crediting rate for duration of investments; rate is only reset at certain intervals.	Minimum crediting rate for duration of investment, rate is only reset at certain intervals.	Typically no minimum crediting rate, rate can fluctuate based on market conditions.
Who manages the assets?	Insurer	One or multiple fixed income managers	One or multiple fixed income managers
Who provides the guarantee?	Insurer	Insurer	Multiple wrap providers selected from insurers, banks, or other financial products companies.
What is the risk of losing protections offered by the guarantee?	If structured properly, the guarantee is backed by full faith and credit of the insurer.	If structured properly, the guarantee is backed by the full faith and credit of the insurer.	Guarantee is backed by the full faith and credit of multiple guarantee providers.
What is the risk of losing access to the assets?	Assets can only be used to satisfy claims of the separate account.	Assets are held by the Plan.	Assets are held by the pooled fund.
What protections are available if a guarantee provider cannot meet its obligations?	If structured properly, state insurance insolvency laws give preferential treatment to policy holder claims.	Insurance insolvency laws give preferential treatment to policy holder claims.	If any guarantee provider cannot meet its obligations, other providers must step in to fulfill that provider's obligations.
Purchase Decision Criteria	Plans that want to insulate their assets from any unrelated claims on an insurer providing stable value products can use a separate account solution, although the guarantee remains backed by the full faith and credit of the insurer.	Larger plans seeking full control of the assets they want allocated to a stable value product can select an insurance-based synthetic guarantee.	Plans seeking the assurance of multiple wrap providers backing the guarantee can select a global wrap product.

Glossary of Terms

- 1) **Book or Contract Value** – For a stable value investment, the value of deposits, plus accumulated interest, minus withdrawals. Unlike market value, book value is not subject to market fluctuations.
- 2) **Book Value Accounting** – The method by which the valuation of a stable value investment is reported. Book Value isolates the plan from the volatility of market fluctuations caused by movements in interest rate or changes in credit ratings.
- 3) **Cash Buffer (Short-Term Investment Fund)** – A money market fund, typically managed by the plan's custodian or trustee bank. STIFs within stable value funds are used as a first source of liquidity by some plans to absorb immediate cash flow needs without requesting withdrawals from other, higher-yielding assets.
- 4) **Cash Flow Risk** – The risk that participant-directed contributions, withdrawals, and net transfers have a financial impact on the issuer of a fixed rate contract or on the crediting rate of an experience-rated contract. Also, the risk that cash flows are different than expected.
- 5) **Commingled or Collective Fund** – A fund that combines unaffiliated plans into one large group to purchase GICs and other stable value products. These funds may also be referred to as pooled funds, bank pooled funds, collective funds, or separate accounts.
- 6) **Competing Fund** – Another investment option in addition to a stable value fund within a defined contribution plan that offers relative principal stability, such as a money market or GIC fund.
- 7) **Crediting Rate** – The interest rate credited on the book value of a stable value fund, expressed as an “effective annual yield.” As determined by the contract, the crediting rate may remain fixed for the term of the transaction or may be reset at predetermined intervals.
- 8) **Credit (or Default) Risk** – The risk that an investment will default, i.e. the borrower (the bond or contract issuer) will not pay interest and principal as scheduled.
- 9) **Equity Wash** – A provision in a stable value product that any transfers made from the stable value fund must be directed to an equity fund option of the plan for a stated period of time (usually 90 days) before the transferred funds may be directed to any other plan-provided competing fixed income fund (such as a money market fund.) This provision is intended to reduce interest rate arbitrage by plan participants, thus permitting stable value contract issuers to underwrite the plan without excessive risk exposure.

- 10) **Fair Market Value (FMV)** – The amount that a willing buyer will pay a willing seller for a future income stream. Fair value is usually reported as market value.
- 11) **General Account** – The primary part of a life insurance company's balance sheet containing the capital and surplus and reserves for guaranteed liabilities. Almost all traditional GICs are backed by the issuer's General Account.
- 12) **Guaranteed Rate** – The rate of return under a guaranteed investment contract for a stated period of time.
- 13) **Guaranteed Investment Contract (GIC)** – A group annuity contract that pays a specified rate of return for a specific period of time, offers book value accounting, typically pays benefits to plan participants, and provides annuities upon request. These contracts are also known as Guaranteed Insurance Contracts or Guaranteed Interest Contracts.
- 14) **Investment Guidelines** – Guidelines established between a plan sponsor or trustee and an investment manager which establish the investment parameters and risk exposures that the investment manager may assume in the plan's account. In fixed income portfolios, the guidelines typically address permissible asset classes and/or securities, sector allocation limits, issuer diversification, and minimum credit quality constraints.
- 15) **Investment Manager** – A fiduciary (other than a trustee or named fiduciary under Sec. 402 of the IRC) who has the power to manage, acquire or dispose of certain plan assets and who has acknowledged in writing that he is a fiduciary with respect to the plan.
- 16) **Market Value (MV)** – The amount an investment (bond, mortgage, stock, or fund share) would be worth if it were sold at a specific time.
- 17) **Market Value Adjustments (MVA)** – More properly referred to as a Surrender Value Adjustment, this is the amount deducted from or added to a stable value product when it is terminated prior to its stated maturity date.
- 18) **Net Crediting Rate** – The interest rate on the book value balance of a stable value product after adjusting for expenses and any special provisions of the product, expressed as an annual effective yield.