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The Role of Stable Value Funds As QDIAs or Otherwise

Though stable value funds might not be appropriate as the qualified default investment alternative for a defined contribution plan, they have an important role to play in retirement savings portfolios.

Prior to the passage of the Pension Protection Act of 2006, it was not uncommon for defined contribution plan participants who failed to select their own investments to see their deferrals defaulted into a stable value fund. Stable value—a relatively low-risk asset class that focuses on capital preservation and liquidity—seemed to be a “safe” option.

The final regulations on qualified default investment alternatives, published by the Department of Labor’s Employee Benefits Security Administration in 2007, addressed the savings previously defaulted into stable value funds, saying they are grandfathered under the protections of the QDIA regulation. And stable value funds were approved as a capital preservation product for an employee’s first 120 days of participation—an option for plan sponsors wishing to simplify administration if workers opted out of participation quickly.

But, during a press conference at the time the final regulations were published, Bradford Campbell, then-assistant secretary for EBSA, stated that stable value funds would likely still be a very big part of QDIAs as underlying investments.

Stable Value Funds and QDIAs

After having some time to see if that prediction would come true, David O’Meara, director of investments at Willis Towers Watson in New York City, says the firm hasn’t seen commonplace use of the QDIA regulation’s 120-day rule.

He adds that he cannot think of a situation where such a conservative investment would be the appropriate default for the majority of a plan’s participants. “We tend to favor multi-asset portfolios designed to best aid participants in growing and preserving retirement assets, so that requires an element of growth investments,” he says.

Still, O’Meara notes, stable value funds have a place in DC plans, and possibly in target-date funds, because research has shown the funds have the ability to generate positive returns, generally, in excess of money market funds, yet at relatively low levels of risk. “So it’s a pretty attractive asset class for participants looking to mitigate the loss of capital, and it’s been very effective in doing so,” he says.

O’Meara says stable value as an investment in DC plans has undergone a lot of evolution over the past 20-plus years. “In the ’90s, stable value funds were primarily insurance-dominated solutions, but they have migrated to short-term bond portfolios with insurance wrappers—or synthetic solutions,” he says. “In addition, increased oversight of the investments, as well as the insurance companies that provide the wrappers, has brought more sustainability to the stable value marketplace. Stable value funds have remained resilient over a number of years, and we expect it to be a strong investment asset class going forward.”

One thing that makes stable value investments unique and valuable is that they are only available in tax-qualified plans such as DC plans, says Tom Schuster, senior vice president and head of MetLife’s stable value business in New York City.

“It’s the best-kept secret in the world of investments from retail investors because they don’t have access,” he says. “And [stable value funds] are uniquely structured to maximize returns while preserving principal.”

Looking objectively at the 45-year track record of stable value funds, they have performed well, offering a reasonable return no matter the market conditions, while preserving principal, Schuster adds. “Even during the Great Recession, periods of rising and falling interest rates, and a pandemic, stable value has performed as designed,” he says.

Though he wouldn’t promote investing 100% of retirement portfolios in stable value funds, Schuster says the asset class does allow for a more tailored risk profile for plan participants.

The “2022 MetLife Stable Value Study” found that more than two-thirds of DC plan sponsors are concerned about the impact of market volatility on retirees (70%), and a similar number are worried about plan participants within 10 years of retirement (67%).

The study also shows there is great interest among advisers and plan sponsors in the potential of stable value to improve participant outcomes. Nearly nine in 10 plan sponsors (89%) and 97% of plan advisers would be interested if a TDF provider could use a solution, such as stable value, that generates net returns four times more than the cost associated with delivering those additional returns (e.g., 60 basis points enhanced net returns for a cost of 15 basis points) while keeping volatility constant. Eighty-six percent of plan sponsors and 94% of plan advisers favor a solution that could maintain comparable returns, net of fees, while reducing volatility by approximately 40%.

"We conduct these studies because we like to rely on what plan sponsors are telling us," Schuster says. "We asked plan sponsors whether, if stable value was approved as a QDIA, they would use it, and 26% of plan sponsors said they would be very or somewhat likely to use it as QDIA for near-retirees, within 10 years of retirement. In addition, 61% of advisers said would be somewhat or very likely to recommend stable value as a QDIA for near-retirees."

"The discussion on QDIAs as it relates to stable value is that, as a standalone QDIA, it might be valid for only near-retirees, but the discussion evolves when thinking about what stable value does well as part of other QDIAs," says Warren Howe, national sales director of stable value markets at MetLife in Wallingford, Connecticut. "It can help optimize returns and lower volatility for certain participants in TDFs, balanced funds and possibly managed accounts."

The Role of Stable Value Overall

The MetLife "Stable Value Study" found a large majority of DC plan sponsors (82%) offer stable value and nearly all DC plan sponsors (98%) say they are not planning to make any changes to their stable value offering. More than nine in 10 stable value fund providers (91%) say plan sponsors chose stable value because its returns are better than those of money market funds and other capital preservation options.

Howe notes that Investment Company Institute data shows that assets in DC plans top $7 trillion, and stable value investments hold more than $900 billion of that, so the asset class plays a significant role in the lineups of DC plans. "Stable value is used in a variety of ways; almost every plan sponsor uses a capital preservation investment option," he says.

While stable value can play a role in investment portfolios for plan participants of all types, depending on individual needs, it may be even more important as participants get closer to retirement and for those in retirement, Howe says. He notes that studies show more participants are keeping their assets in plans after retirement, and he points out that even among younger participants, individuals have different risk tolerances.

Primarily, investors in stable value funds happen to be those closer to retirement, which O'Meara says is most appropriate and where he would expect to find the majority of stable value assets. "Within five or 10 years from retirement is when we see participants starting to gravitate to conservative options within DC plans, and we think that's about right," he says.

However, he notes that for those who are a decade out from retirement, assets are not necessarily expected to be spent right at retirement, so only a portion of their portfolios need to be in a low-risk investment option in case money is needed in the short term regardless of market environment.

For younger, newer or mid-career participants, stable value funds might have a place in DC plans to the extent participants are not using their savings only for retirement, O'Meara says.

"We have to recognize that the number of participants who tap into their savings during their career is not insignificant," he says. "For those with more acute near-term needs, putting assets into a conservative investment might be beneficial—though one can argue whether it's their best option and that they need a long-term vision for their savings.

"[Stable value] certainly deserves a place in DC plan investment lineups, and if you look at the glide paths of TDFs, it makes sense that there is very little in fixed-income investments for people with longer time horizons, but as people get closer to retirement, stable value becomes a bigger part of the portfolio," he says.