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RPAG Webinar- Stable Value in a Rising Rate Environment

May 2022

Withdrawal Risk in Stable Value Funds

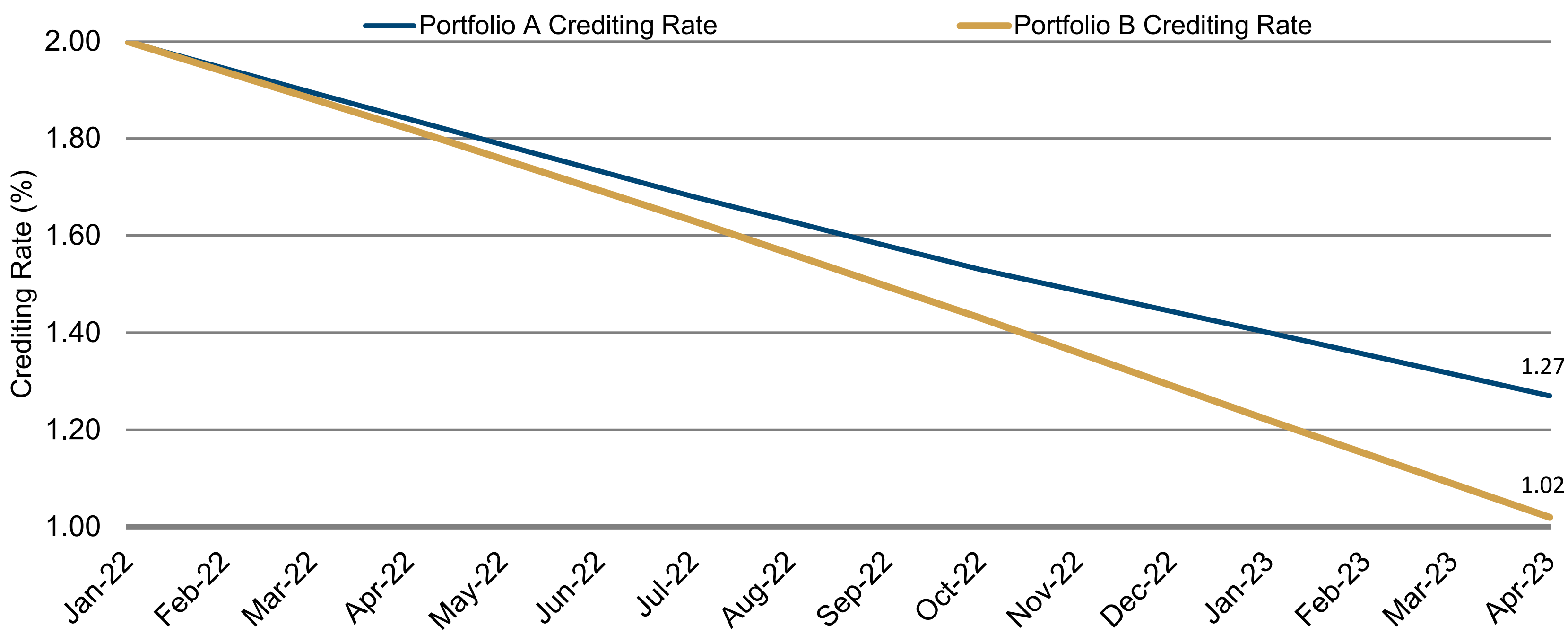
- Withdrawal risk is defined as the probability that a manager will need to sell securities from their long-term strategies (generally, the synthetic GICs) to fund participant and/or plan redemptions

- Evaluating this risk in a stable value strategy is important because of the uncertain nature of cash flow into and out of the fund, both of which affect the crediting rate. Changes in the crediting rate alter future returns, particularly if outflows are met by accessing the wrap contracts on synthetic investments.

- Withdrawal risk is more acute and potentially more detrimental during periods of rising interest rates and/or widening credit spreads.
  - If bonds are sold from wrapped strategies to fund withdrawals at a discount/loss, that loss is embedded in the market-to-book ratio of that strategy, as the securities sold do not have any chance to recover the losses.
  - This is important because the market-to-book ratio is one of the key determinants of the crediting rate for synthetic GICs (along with portfolio yield).

- Due to the challenges in projecting cash flow, we believe it is prudent to build ongoing, permanent liquidity into a stable value fund's structure. Specifically, creating a structure with scheduled maturities at par may prevent managers from having to sell assets from their wrapped strategies to accommodate potential outflows.

Accessing wrap contracts for withdrawals in a rising rate environment can negatively impact crediting rates

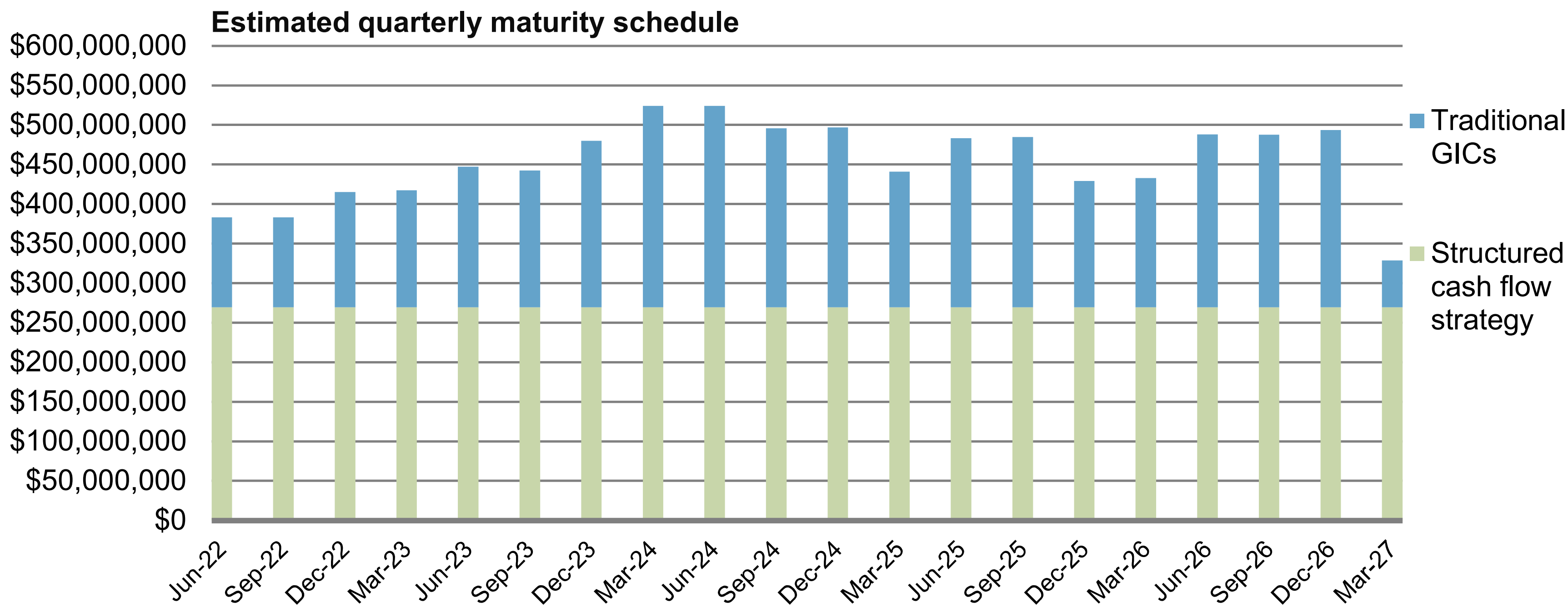


- The chart above is a hypothetical comparison. Two stable value portfolios begin with the same yield (2%), duration (3 years), and market-to-book ratio (100%). Then the following market/cashflow scenario occurs:
    - Interest rates rise by 25 basis points for five consecutive quarters. During this time, each fund's yield rises by the same amount (0.25% per quarter) while the duration of each fund stays constant
    - Both funds have redemptions that represent 2% of total assets under management each quarter
    - Portfolio A handles the withdrawals through its liquidity structure (without selling bonds from its wrapped strategies), while Portfolio B is forced to sell bonds from its wrapped strategies to fund the withdrawals
- At the end of the five quarters, the crediting rate on Portfolio A is 0.25% higher than Portfolio B

Source: Putnam

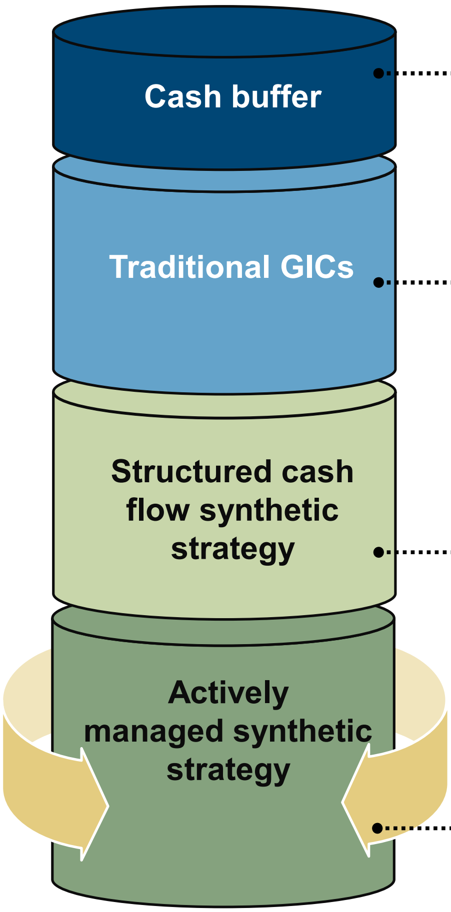
Liquidity is at the forefront of our investment process

- Conservative investment style focused on liquidity management
  - Review of recent historical participant activity, particularly gross withdrawals
  - Review maturing cash flow stream
  - Seek to generate 1.5%–3.0% of the strategy in cash flow per quarter at the portfolio level



Source: Putnam, as of 3/31/22.
No assurance can be given that the investment objective or target return will be achieved or that an investor will receive a return of all or part of his or her initial investment. As with any investment, there is a potential for profit as well as the possibility of loss.

Withdrawal hierarchy protects portfolio structure by lowering liquidity risk



Tier 1 **Cash and net cash flow**
- Minimum cash required of 5%
- Periodically, up to 20% in floating rate GICs may be employed as an additional liquidity layer between cash and traditional GICs

Tier 2 **Traditional GICs**
- "Last in, first out" liquidity structure
- Issuer maximum of 15%; typical exposure no more than 10%
  - Three tiers of approved issuers, exposure dependent on size, credit quality, and business diversification of issuer
- Final maturity no longer than seven years; typically no longer than five years

Tier 3 **Third-party wrap synthetic: structured cash flow**
- Wrap provided by American General, MassMutual, New York Life, and Transamerica
- Managed to Bloomberg 1-5 Year Government/Credit Index
- Custom guidelines designed to generate 5% cash flow of the contract per quarter

Tier 4 **Third-party wrap synthetic: actively managed portfolio**
- Wraps provided by American United Life, MetLife, Pacific Life, and Prudential PLC
- Managed to Bloomberg Intermediate U.S. Aggregate Index
- Pro-rata withdrawals

For illustrative purposes only.

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