

**Insights**

## **JUST HOW STABLE ARE STABLE VALUE FUNDS?**

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The Employee Retirement Income Security Act (ERISA) imposes significant responsibilities on fiduciaries in managing retirement plans. Historically, stable value funds may have been seen as an uncontroversial option for defined contribution retirement plans to include in their investment menus, but recently there has been an uptick in litigation questioning the selection of particular stable value funds. Many of these lawsuits have focused on the specific fund's requirements, restrictions, or performance compared to other, similar products available in the market. However, some of these lawsuits have suggested that stable value funds may not be safe investments at all, citing potential default risks that plan fiduciaries should take into account when selecting and monitoring these investments. This article summarizes a few of the key risks that may make stable value funds less stable than you once thought.

### **WHAT IS A STABLE VALUE FUND?**

A stable value fund is an investment option with a primary objective of preserving a participant's principal while still providing steady, predictable growth. Stable value funds invest in high-quality bonds and similar fixed-income securities, making them a low-risk investment in theory. These funds are often protected by guaranteed insurance contracts (GICs) that guarantee account balances will not fall below a specified threshold, despite market activity. The interest earned in connection with investment in a stable value fund has historically exceeded interest earned on money market funds; however, the risk is generally assumed to be much lower than with other types of investments.

### **FIDUCIARY OBLIGATIONS UNDER ERISA**

ERISA imposes important obligations on retirement plan fiduciaries, including that fiduciaries must act solely in the interest of the participants and beneficiaries and manage the plan with care, skill, prudence, and diligence. Fulfilling these duties specifically requires prudent investment of plan assets, diversification of plan investments, following the terms of the plan, and paying only reasonable and necessary expenses.

### **POTENTIAL RISKS WHEN SELECTING STABLE VALUE FUNDS**

- **Costs & Restrictions:** Fiduciaries should ensure they understand all requirements or restrictions relevant to any stable value fund that may translate to additional costs (and therefore lower returns to participants). For example, if a stable value fund may apply a “market value adjustment” on a plan-wide termination of the investment (or of the plan itself), such adjustment may result in a direct reduction in a participant’s account balance and impair a plan sponsor’s ability to change the plan’s investment menu. In addition, if a stable value fund includes an “equity wash” requirement that prevents money from being transferred directly to a competing fund, a participant could lose value as a result of such delay.
- **Provider Benefits:** Problems arise when fiduciaries choose or maintain funds that underperform compared to similar options in the marketplace or when conflicts of interest influence decision-making. If a provider benefits disproportionately from an arrangement, such as earning significant spreads (the difference between what an investment actually earns and the crediting rate guaranteed by the insurance company) while participants receive crediting rates above the guarantee but nevertheless materially lower than what the underlying investment earns, this can raise concerns about breaches of fiduciary duties. Stable value funds are often sponsored by the plan’s recordkeeper. While there is nothing inherently improper about offering the recordkeeper’s stable value fund, the potential for a conflict enhances the need for a careful, well-documented approach to monitoring in such instances.
- **Plan Fees:** Fiduciaries should monitor the fees incurred for recordkeeping and administrative services related to stable value funds to ensure they are reasonable compared to the fees being charged in connection with substantially similar investments (e.g., other stable value funds or alternative low-risk investments) otherwise available in the market.
- **Investment Selection & Monitoring:** Employers should implement a prudent review process for investments to ensure they are maximizing returns for participants, taking into account fees that are or could be assessed in determining actual returns. In particular, stable value funds that utilize separate account GICs, in which the invested amounts are maintained in a segregated account rather than as part of the insurer’s general assets, may have lower crediting rates compared to traditional GICs, in which the invested amounts are maintained with the insurer’s general assets. Additionally, separate account GICs may have higher fees from money managers and less flexibility for fund managers when choosing investments.

While stable value funds may still be stable in many ways, recent litigation highlights that fiduciaries must exercise caution when selecting and monitoring these investments just like they do for other investments.

We recommend taking a minute today to make sure your stable value fund really is stable by reviewing it against the above criteria.

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## MEET THE TEAM



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