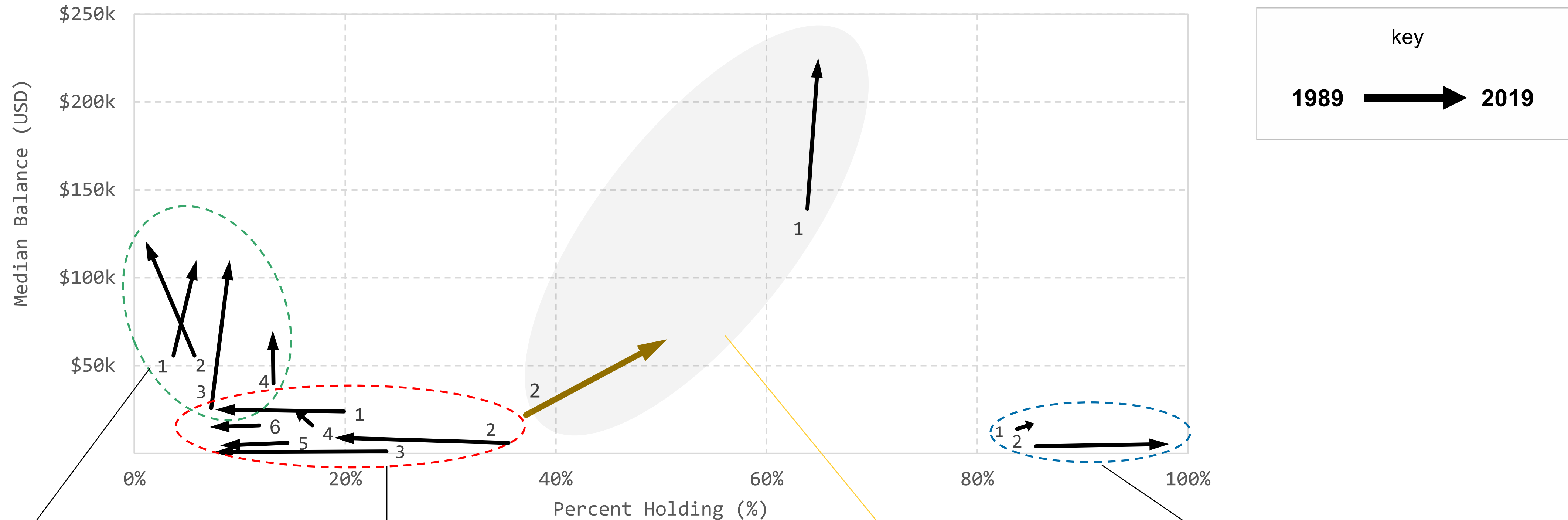
Balance Sheets of the American Household

Since the 1980s, primary residence & retirement accounts have been the store-of-value pillars for the middle class



Limited Ownership, Gained Value

1 Other Managed Assets
2 Directly Held Bonds
3 Pooled Investment Funds
4 Other Residential Real Estate

Declining Ownership, No Gain in Value

1 CDs
2 Cash Value Life Insurance
3 Savings Bonds
4 Directly Held Stocks
5 Other Financial Assets
6 Other Non-Financial Assets

Broadly Owned, Gained Value

1 Primary Residence
2 Retirement Accounts

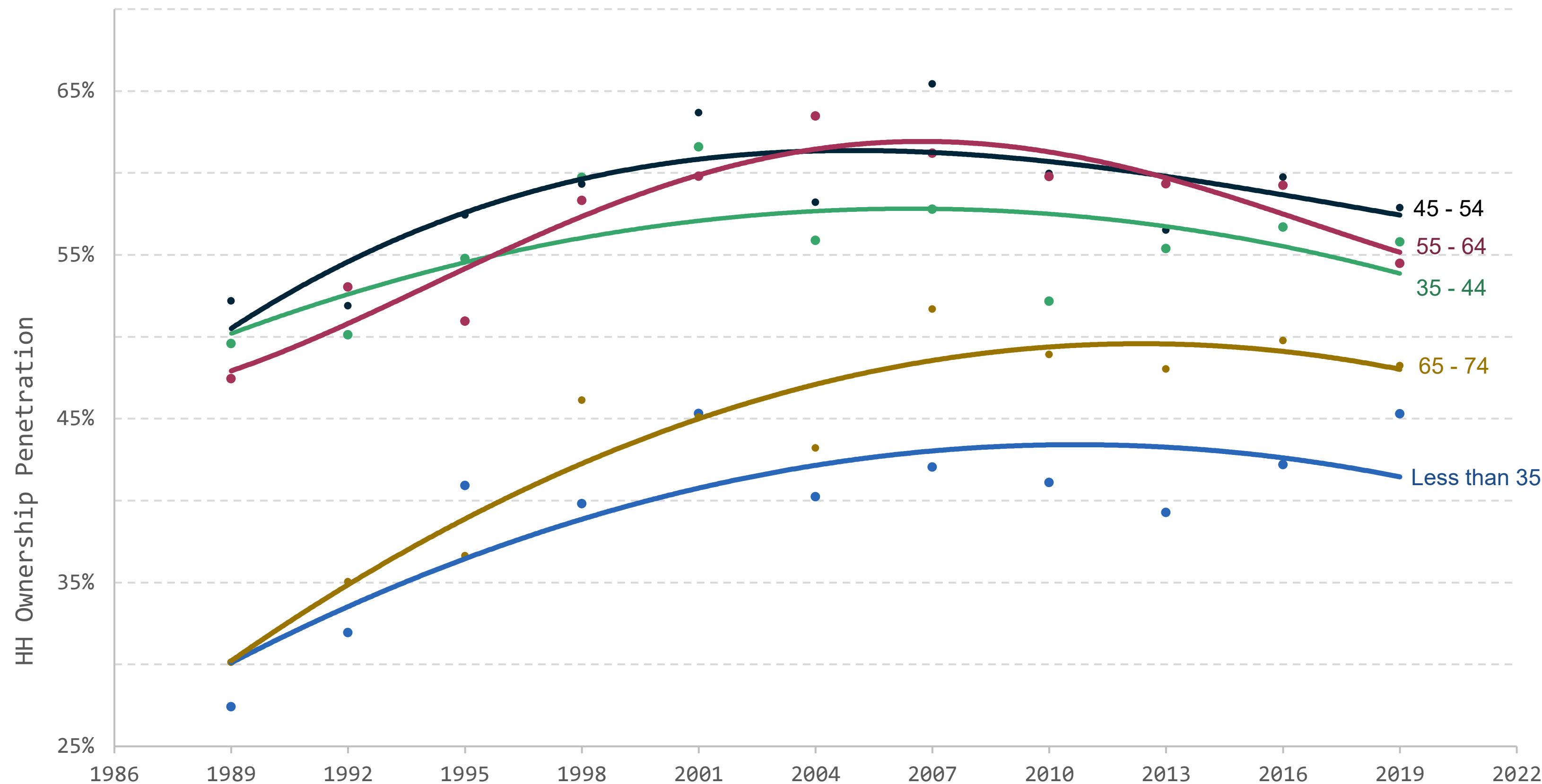
Broadly Owned, No Gain in Value

1 Vehicles
2 Transaction Accounts

Source: Federal Reserve Survey of Consumer Finances, 1989 & 2019.

Retirement Account participation peaked around 2008

Policy is aware of the problem … SECURE Act (2019) was the initial attempt to address a system in structural decline

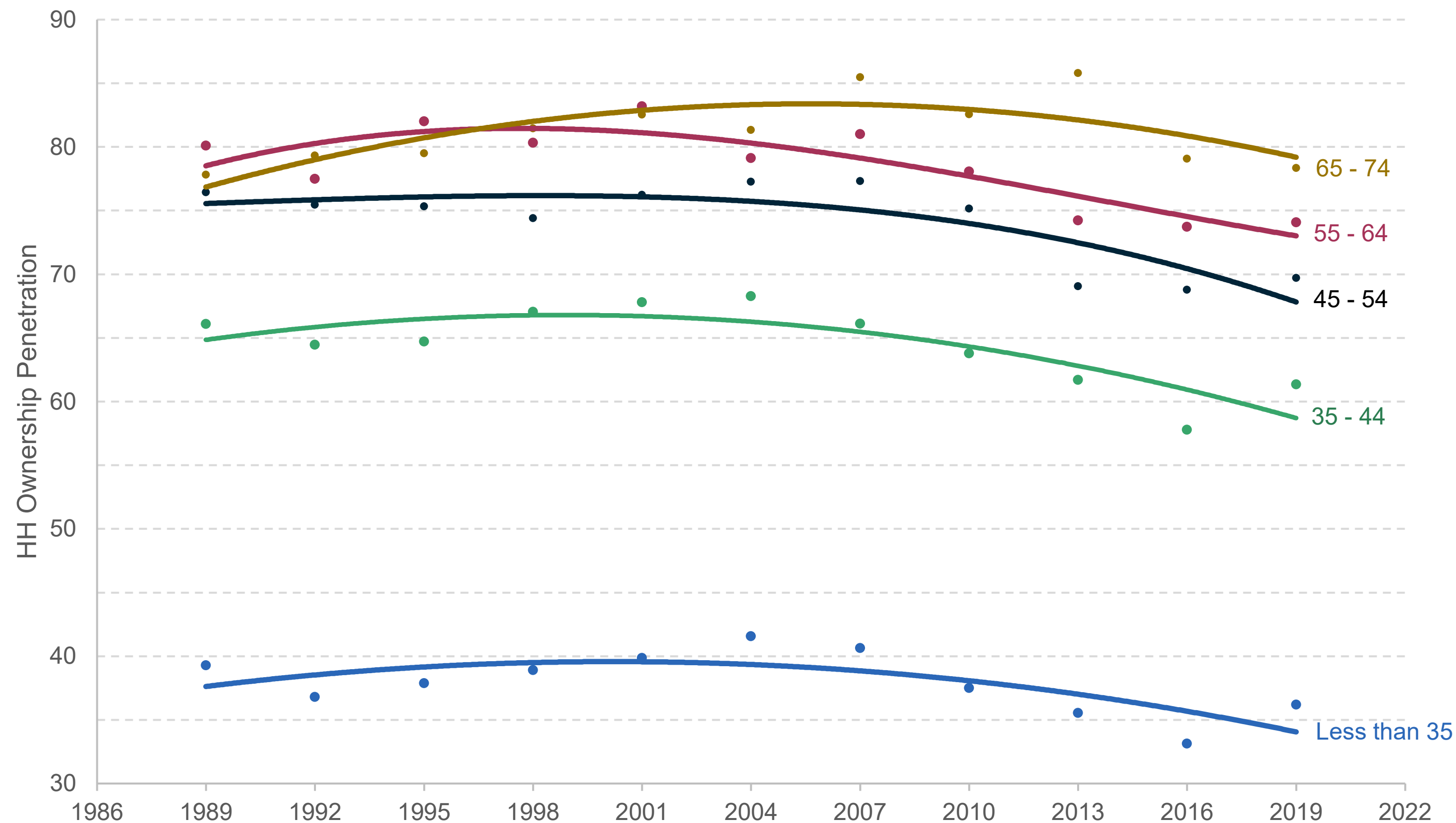


Secure Act "1.0" (2019)

- Expanded retirement plan access to some part-time workers (*more access*)
- Pushed back required minimum distributions to age 72 (*work & save longer*)
- Increased max contributions for 401(k) auto-enrollment (*save more*)
- Increased tax benefits for small businesses (*more access*)

Side Note: Same cracks show up in primary residence ownership

Problem shows up clearly in both pillars of American middle-class savings …



Source: Federal Reserve Survey of Consumer Finances

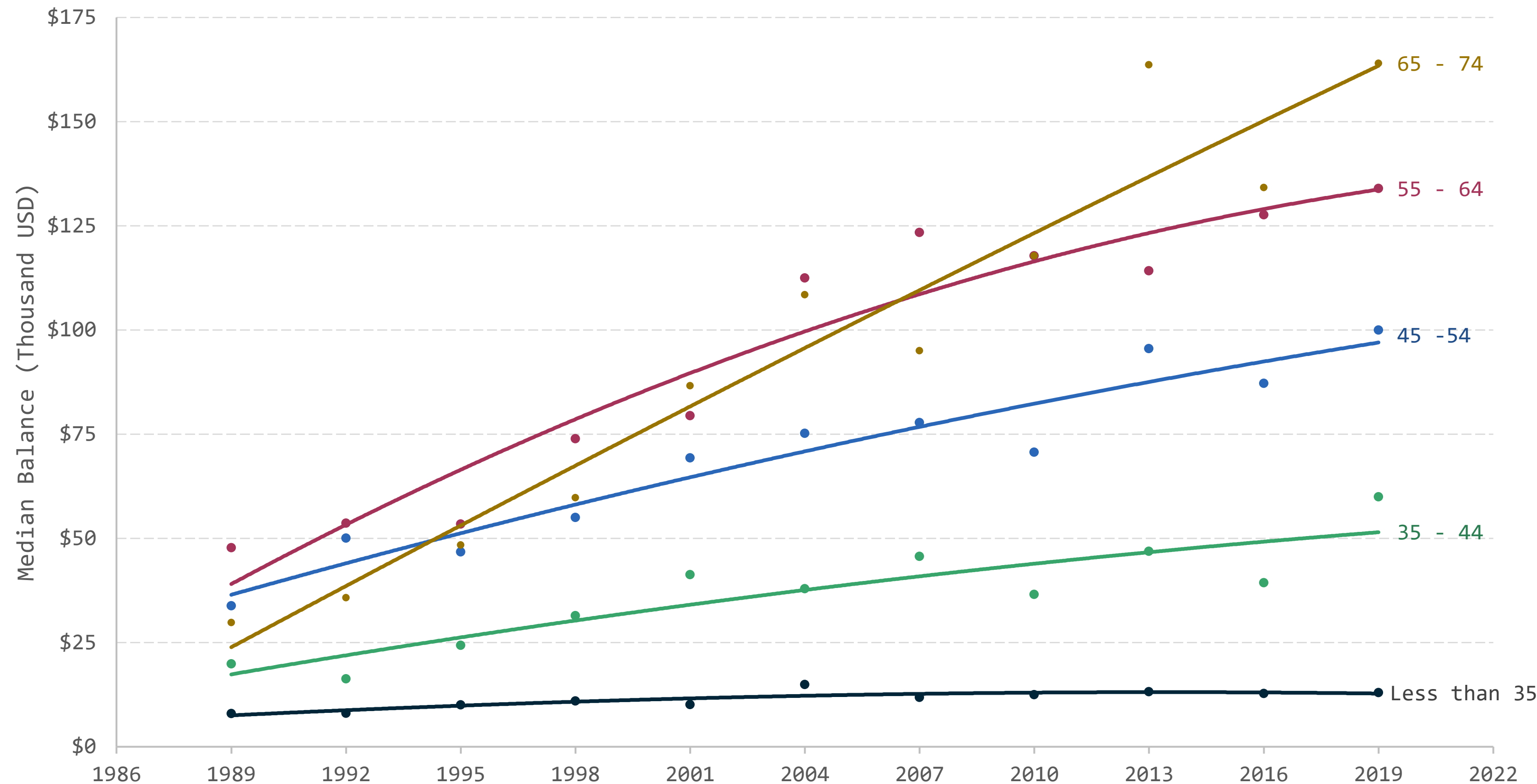
… and to avert disaster in the most recent crisis, Fed purchased more Agency MBS than US Treasury debt to support the housing market in the last QE.

START	END	TREASURIES	AGENCIES	AGENCY MBS
March 2020	March 2022	$2,916		$2,926
September 2012	October 2014	$790		$823
November 2010	June 2011	$600		
November 2008	March 2010	$300	$175	$1,250

Source: Katherine Greifeld, "Fed's Biggest-Ever Bond-Buying Binge Is Drawing to a Close," Bloomberg, March 9, 2022.

Financial returns have inflated Retirement Account balances

Duplicating these results for today's workforce would require a repeat in similar stock & bond return performance to the prior 40 years …



What are these retirement accounts holding?

“Target Date Funds” captured the default setting in employer-sponsored retirement plans with the Department of Labor’s QDIA rule in 2008

Fact Sheet

U.S. Department of Labor
Employee Benefits Security Administration
April 2008

Regulation Relating to Qualified Default Investment Alternatives in Participant-Directed Individual Account Plans

Background

- Approximately one-third of eligible workers do not participate in their employers’ 401(k)-type plans. Studies suggest that automatic enrollment plans (in which workers “opt-out” of plan participation rather than “opt-in”) could reduce this rate to less than 10%, significantly increasing retirement savings.
- The Pension Protection Act (PPA) President Bush signed into law in 2006 removed impediments to employers adopting automatic enrollment, including employer fears about legal liability for market fluctuations and the applicability of state wage withholding laws.
- These impediments had prevented many employers from adopting automatic enrollment, or had led them to invest workers’ contributions in low-risk, low-return “default” investments.
- The PPA directed the Department of Labor to issue a regulation to assist employers in selecting default investments that best serve the retirement needs of workers who do not direct their own investments.
- The Department issued a proposed regulation on September 27, 2006, and received more than 120 public comments. After considering the many issues raised by commenters, the Department’s Employee Benefits Security Administration promulgated the final regulation on October 24, 2007.

Overview of Final Regulation

- By facilitating the adoption of automatic enrollment plans, and by encouraging investments appropriate for long-term retirement savings, the Department estimates the rule will result in between $70 billion and $134 billion in additional retirement savings by 2034.
- The final regulation provides the following conditions that must be satisfied in order to obtain safe harbor relief from fiduciary liability for investment outcomes:
  - Assets must be invested in a “qualified default investment alternative” (QDIA) as defined in the regulation.
  - Participants and beneficiaries must have been given an opportunity to provide investment direction, but have not done so.
  - A notice generally must be furnished to participants and beneficiaries in advance of the first investment in the QDIA and annually thereafter. The rule describes the information that must be included in the notice.
  - Material, such as investment prospectuses, provided to the plan for the QDIA must be furnished to participants and beneficiaries.
  - Participants and beneficiaries must have the opportunity to direct investments out of a QDIA as frequently as from other plan investments, but at least quarterly.
  - The rule limits the fees that can be imposed on a participant who opts out of participation in the plan or who decides to direct their investments.
  - The plan must offer a “broad range of investment alternatives” as defined in the Department’s regulation under section 404(c) of ERISA.
- The final regulation does not absolve fiduciaries of the duty to prudently select and monitor QDIAs.

Qualified Default Investment Alternatives

- The final regulation does not identify specific investment products – rather, it describes mechanisms for investing participant contributions. The intent is to ensure that an investment qualifying as a QDIA is appropriate as a single investment capable of meeting a worker’s long-term retirement savings needs. The final regulation identifies two individually-based mechanisms and one group-based mechanism – it also provides for a short-term investment for administrative convenience.

- The final regulation provides for four types of QDIAs:
  - A product with a mix of investments that takes into account the individual’s age or retirement date (an example of such a product could be a life-cycle or targeted-retirement-date fund);
  - An investment service that allocates contributions among existing plan options to provide an asset mix that takes into account the individual’s age or retirement date (an example of such a service could be a professionally-managed account);
  - A product with a mix of investments that takes into account the characteristics of the group of employees as a whole, rather than each individual (an example of such a product could be a balanced fund); and
  - A capital preservation product for only the first 120 days of participation (an option for plan sponsors wishing to simplify administration if workers opt-out of participation before incurring an additional tax).
- A QDIA must either be managed by an investment manager, plan trustee, plan sponsor or a committee comprised primarily of employees of the plan sponsor that is a named fiduciary, or be an investment company registered under the Investment Company Act of 1940.
- A QDIA generally may not invest participant contributions in employer securities.

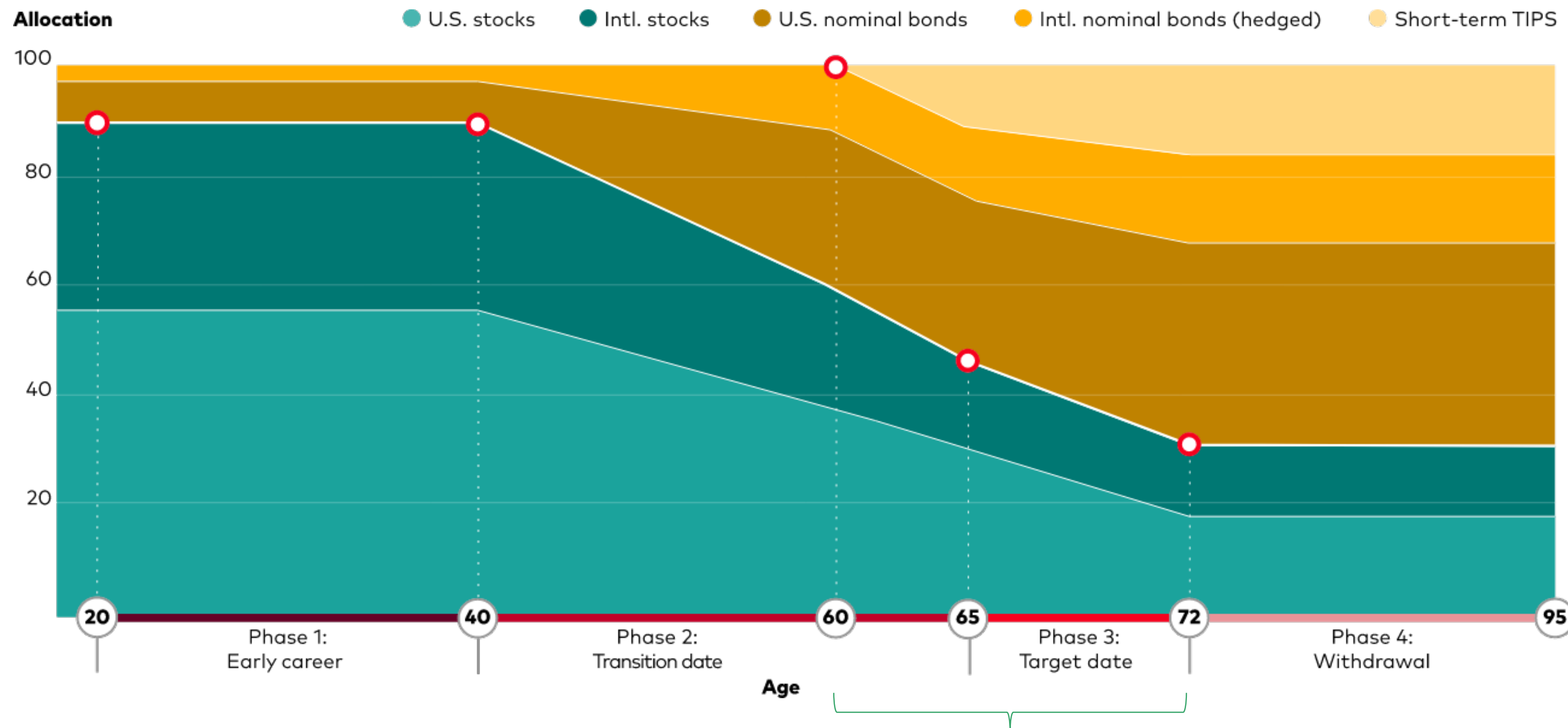
Other Significant Provisions

- Recognizing that some plan sponsors adopted stable value products as their default investment prior to passage of the Pension Protection Act and this final regulation, the regulation provides a transition rule. The regulation “grandfathers” these arrangements by providing relief for contributions invested in stable value products prior to the effective date of the final rule. The transition rule does not provide relief for future contributions to stable value products.
- The final regulation clarifies that a QDIA may be offered through variable annuity contracts or other pooled investment funds.
- The rule provides that ERISA supersedes any State law that would prohibit or restrict automatic contribution arrangements, regardless of whether such automatic contribution arrangements qualify for the safe harbor.

A copy of the regulation is available on the agency’s Web site at www.dol.gov/ebsa under “Laws and Regulations.”

What is a Target Date Fund (“TDF”)?

Financial industry firms pitch a “glide path” investment mix between stocks and bonds, which basically follows the “own your age in bonds” heuristic.

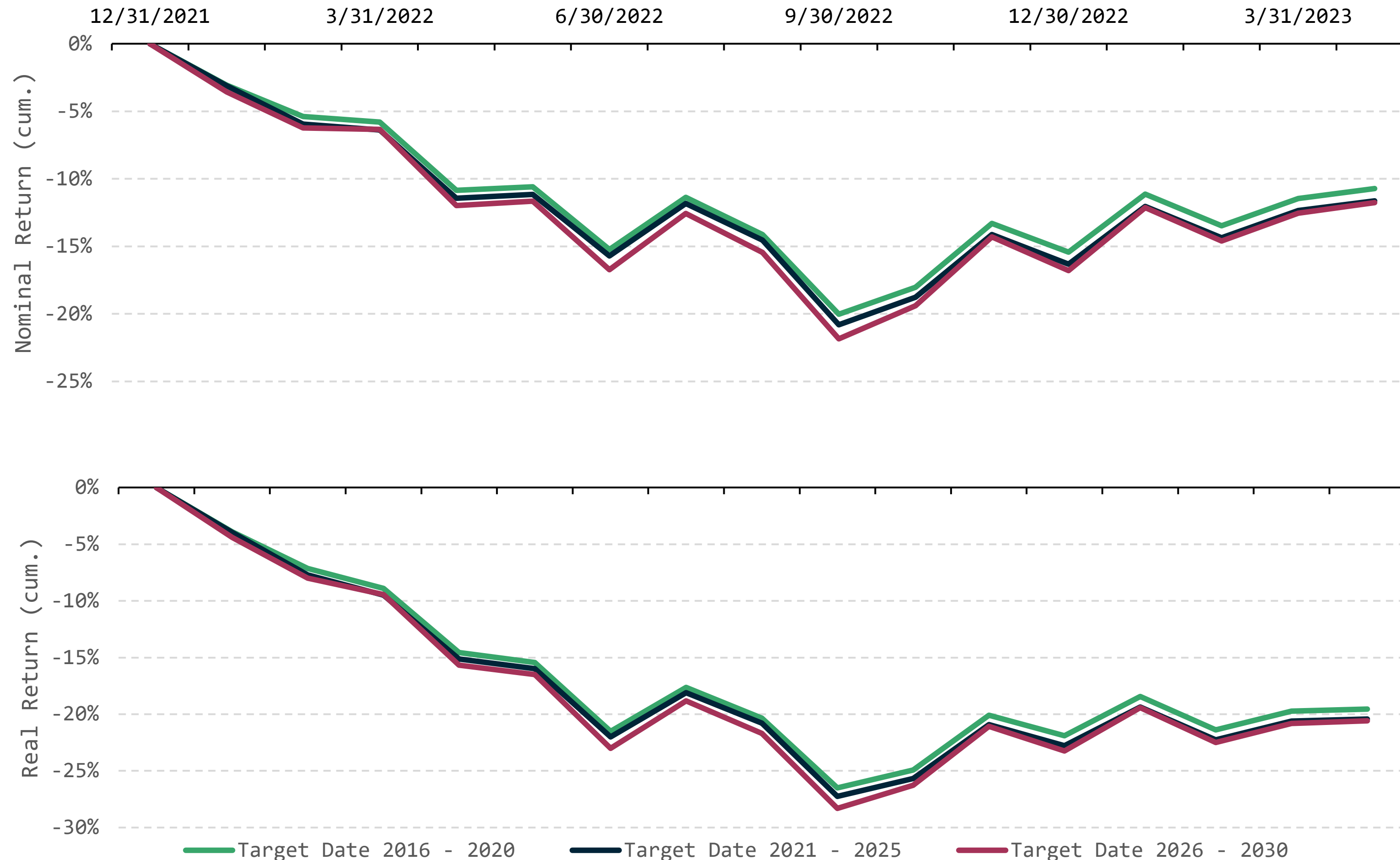


Source: Vanguard

Note that with an older workforce, mix will gradually skew towards bonds …

Near-dated TDFs have lost ~1/5 of purchasing power since 2022

Poor timing as the largest cohort of retirees exits the workforce in American history



Statements now show accounts down ~10% since 12/31/2021 … was over 20% in September '22

… but purchasing power (vs CPI) is still down ~20% since 12/31/2021, after being down over 25% in September '22

Source: Bloomberg, Bureau of Labor Statistics

SECURE Act 2.0 puts another bandage on the system

Bundled into the Consolidated Appropriations Act in December 2022 just three years after the original attempt at a legislative fix

- Mandatory employee enrollment and automatic savings escalation for employers having greater than 10 employees, been in business for at least three years, and offering a new 401(k) or 403(b) plan
- Roth accounts in employer accounts encouraged (pay tax today)
- More part-time employees eligible (two years of 500+ annual hours, versus three in original SECURE Act)
- New Required Minimum Distributions table based on birth date: turn 72 in 2023 = RMD begins age 73; turn 74 after 12/31/2032, RMDs begin at age 75; Effect = work longer
- Starting 2024, student loan repayment is treated as the employee's salary deferral and is eligible for the employer's savings match