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September 3, 2024

George Pantazopoulos, Executive Secretary
ERISA Advisory Council
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Ave, NW
Washington, DC 20210

via email to ERISAAdvisoryCouncil@dol.gov

Statement to the ERISA Advisory Council on Lifetime Income & QDIAs

The Stable Value Investment Association (SVIA) is pleased to provide a statement to the ERISA Advisory Council on retirement income options in defined contribution plans.

Summary

SVIA is proposing to the ERISA Advisory Council two enhancements to directly benefit the retirement income space. Both enhancements address the retirement decumulation crisis by providing retirees with a guarantee of principal and a predictable, low-risk income stream, ensuring financial stability and longevity of lifetime retirement savings without adding complexity or new products to defined contribution plans:

- Extend the current Qualified Default Investment Alternative (QDIA) safe harbor status for stable value investments to specific age cohorts as a retirement income option, and
- Recommending safe harbor status to existing QDIAs as defined by Section 404(c)(5)(e) of ERISA that utilize stable value for principal preservation near and in retirement. This would make the selection of stable value as a decumulation tool within existing QDIA options a protected decision for the managers of those investment vehicles.

What is stable value?

Stable value refers to a low-risk asset class that focuses on capital preservation and liquidity while providing steady, positive returns to participants. It is available exclusively in tax-qualified savings plans, such as defined contribution plans, and in some tuition assistance plans.

Although the structure and investments within stable value products can vary, they all share a key feature: the use of investment contracts issued by banks and insurance companies. These contracts help deliver consistent returns and allow participants to transact at their invested balance plus any accrued interest, a characteristic known as benefit responsiveness.

Stable value has consistently delivered on its objectives over the years and is one of the few investments that did not lose money during the financial crisis of 2008 or the COVID pandemic in 2020. Stable value is an integral component of defined contribution plans, representing between 9-18% of all defined contribution assets over time,[i] and is currently offered in approximately 3 out of 4 plans.[ii]

Introduction

Since their inception, defined contribution plans have primarily focused on asset accumulation, and as more participants enter retirement, the investment options targeted to the decumulation phase have come under increased scrutiny. Such scrutiny has revealed a significant gap in retirement planning. Investment options designed to maximize growth at the expense of increased risk of principal loss fall short in providing strategies for the decumulation phase, which involves converting these savings into a reliable income stream during retirement. As a result, many retirees face uncertainty and financial instability, struggling to manage their withdrawals and fund balances in a way that ensures their savings last throughout their retirement years. At the heart of this issue is the risk of market volatility, where a significant market downturn can impact retirees' current investments and jeopardize their future financial security. This lack of guidance on decumulation strategies can lead to issues such as outliving one's savings, mismanaging withdrawals, locking in losses due to market volatility, and failing to maintain a consistent standard of living.

The association believes that defined contribution plans already have a solution for retirement income in the form of stable value, and that expanding stable value's QDIA status to near and through retirement age cohorts will allow plan sponsors to better utilize stable value as an automated retirement income tool, either on its own or as part of an age-based fund glide path.

Stable value is a unique product that combines preservation of invested principal with full participant liquidity on a daily basis, creating an effective tool for retirement income that provides participants with positive income growth and principal protection in the event of a severe market downturn. Stable value is a mature industry, currently representing around 10% of all retirement assets,[iii] and is not a new, untested product. It is highly valued by plan participants near and in retirement as a way to manage the volatility in their portfolios and has been serving the defined contribution market since its inception, weathering numerous financial crises and delivering on its promises to plan participants for decades.

Stable value's status as a QDIA for the first 120 days of participation in a plan recognizes that while other default investments are better suited to help participants with their accumulation journey, when it comes to protecting principal and reducing volatility, stable value is the best choice. Expanding the ability of plan sponsors to utilize stable value during the later stage accumulation phase and the decumulation phase will further benefit participants and retirees by providing them with the tools to accomplish and execute their retirement goals.

Background

First introduced in the 1970s, stable value is the most common capital preservation option in defined contribution plans, currently offered in more than 240,000 plans with around $900 billion invested, according to SVIA research as of year-end 2022. Plan sponsors offer stable value to their participants, and participants invest in stable value, as it provides a distinctive combination of benefits:

- Principal preservation
- Consistent, positive returns that move in the direction of market interest rates
- Daily liquidity for participants

These benefits make stable value ideally suited for participants seeking to protect their retirement savings and provide a source of income during retirement. In fact, during a 2021 study conducted by the SVIA, which looked at recordkeeper data for 26.6 million participants from 2010 through 2019, nearly 85% of stable value assets were held by participants 50 and older, suggesting that many participants whose savings would be unable to withstand a severe market downturn are already utilizing stable value as a retirement income tool. Data from the Employee Benefits Research Institute (EBRI) as of 2022 shows a similar trend, with the amount of stable value held in participant portfolios increasing steadily as age increases, and those in their 60s holding an average of 10% of their assets in stable value, the highest amount of any age cohort.

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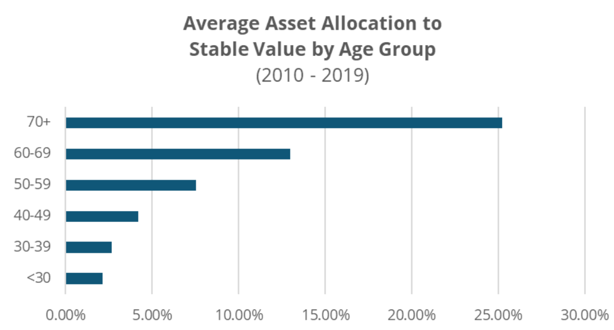
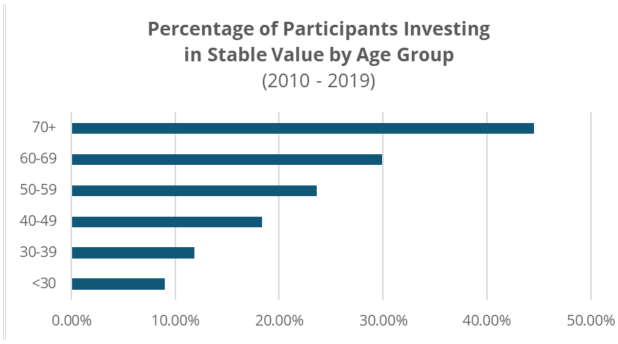
SVIA 2021 Recordkeeper Survey Results





Stable value's utility as a retirement income tool has not gone unnoticed. Many custom target date fund structures utilize stable value in their glide path as a preferred alternative to short- to intermediate-term bonds or money market funds, as stable value offers a similar return profile to bond funds with lower volatility than money markets. Some 529 college savings plans utilize custom target funds with a glide path comprised of 100% stable value to maximize returns while minimizing volatility during their withdrawal phase.

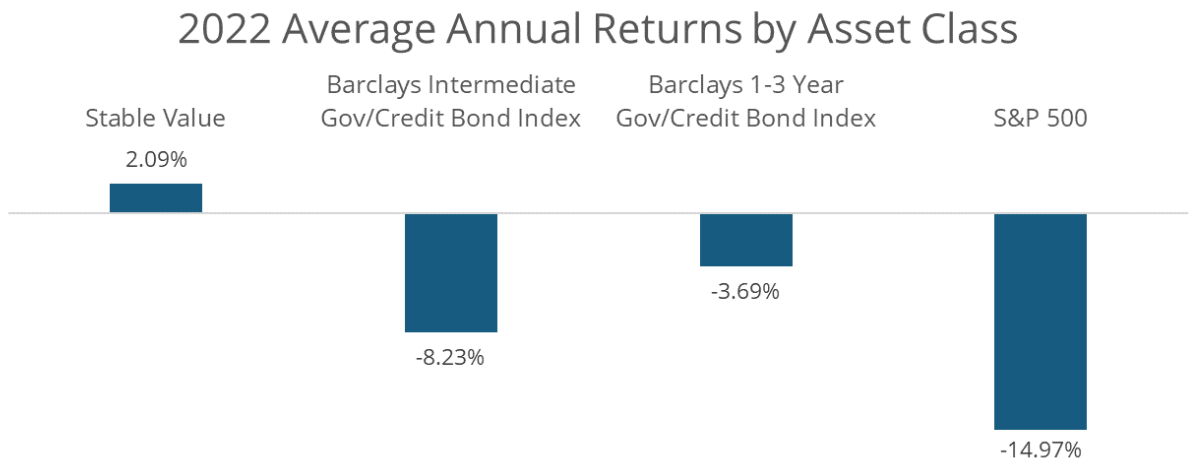
Why stable value is a good choice for retirement income

Retirement income solutions must strike a balance between safety and longevity; the money needs to be there when a retiree needs it, and it needs to last as long as possible. Stable value offers a unique combination of a principal protection guarantee with returns that have outperformed other low-risk investments over time. It provides retirees a stable pool of assets to fund retirement income needs, guaranteeing a stable net asset value while still earning a predictable and positive return. Unlike other retirement income solutions that also feature a guarantee, stable value offers participants full liquidity at any time, recognizing that their needs may change and that locking them into one specific solution may not be prudent. Stable value also allows beneficiaries to inherit the remaining balance, whereas purchasing an annuity or another guaranteed option might not provide the same benefit, as the remaining funds may not be passed on depending on the type of annuity chosen.

While existing QDIA options are excellent accumulation vehicles for participants who choose not to elect their own investment lineup, the level of risk that these funds take on does not necessarily match participants' needs when looking for a retirement income solution, nor is it always readily apparent what that level of risk is. In fact, a 2023 study found that 68% of participants mistakenly believe target date funds to be insured. A one-size-fits-all approach works when accumulating assets, but the decumulation phase is highly personal and determined by various factors and life circumstances.

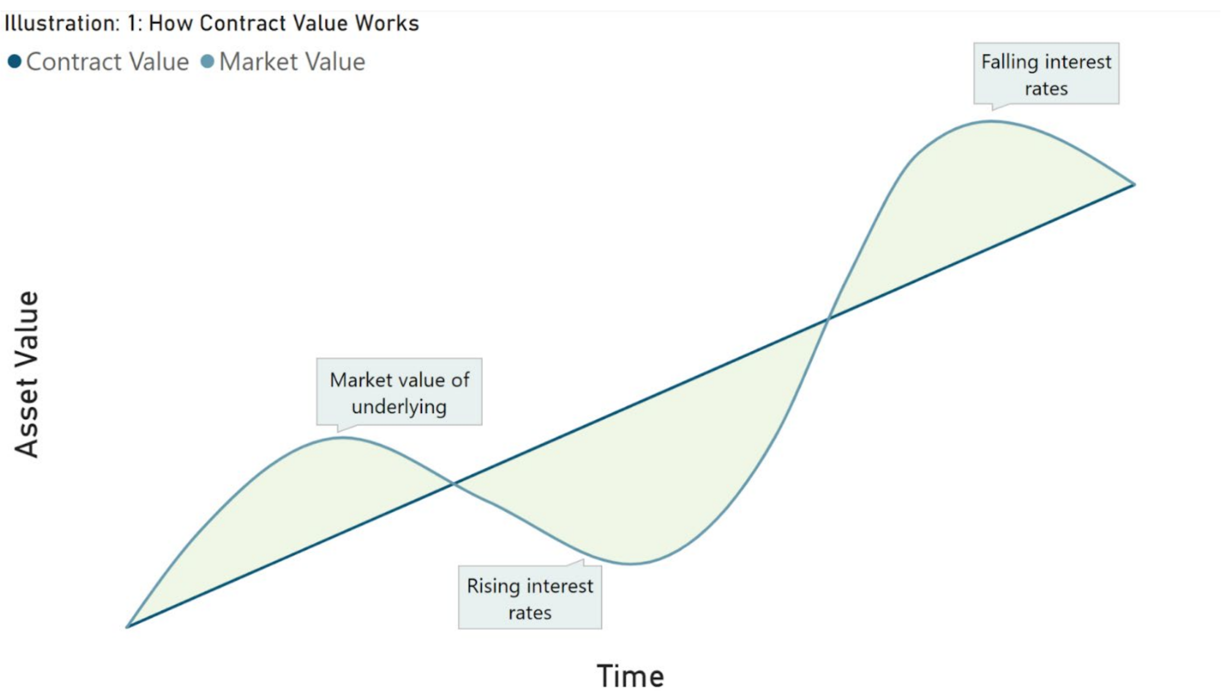
Age-based fund construction provides a decreasing risk profile as participants move along the glide path and into retirement, with lower risk generally characterized by an increased allocation to traditional fixed income. The logic behind this construction approach is consistent with the time-tested investment philosophy that investors with a longer investment horizon (i.e. those that are many years away from retirement) should maximize growth because they can absorb significant mark-to-market volatility. By contrast, investors at or near retirement and in the decumulation phase (i.e. those who rely on their nest egg to fund everyday living expenses) may be more adversely impacted by a severe market downturn and therefore may receive more utility from investments that provide principal preservation. The market environment of 2022, an environment where both equity and fixed income assets saw a significant loss in value, highlighted the flaws in reliance on fixed income to lower volatility and reduce risk. Therefore, it is important for the ERISA Advisory Council to consider stable value as an appropriate and beneficial investment for near and through retirement vintages along the glide path because of the asset class's risk reducing and diversification benefits and ability to offer consistent and predictable long-term growth.

In fact, a 2018 study by Dr. David F. Babbel of the University of Pennsylvania, which analyzed the performance of stable value funds relative to other asset classes, found that including stable value in model portfolios considerably increases expected net return without increasing risk, and that no other asset class was found to have these same benefits.



How does stable value work?

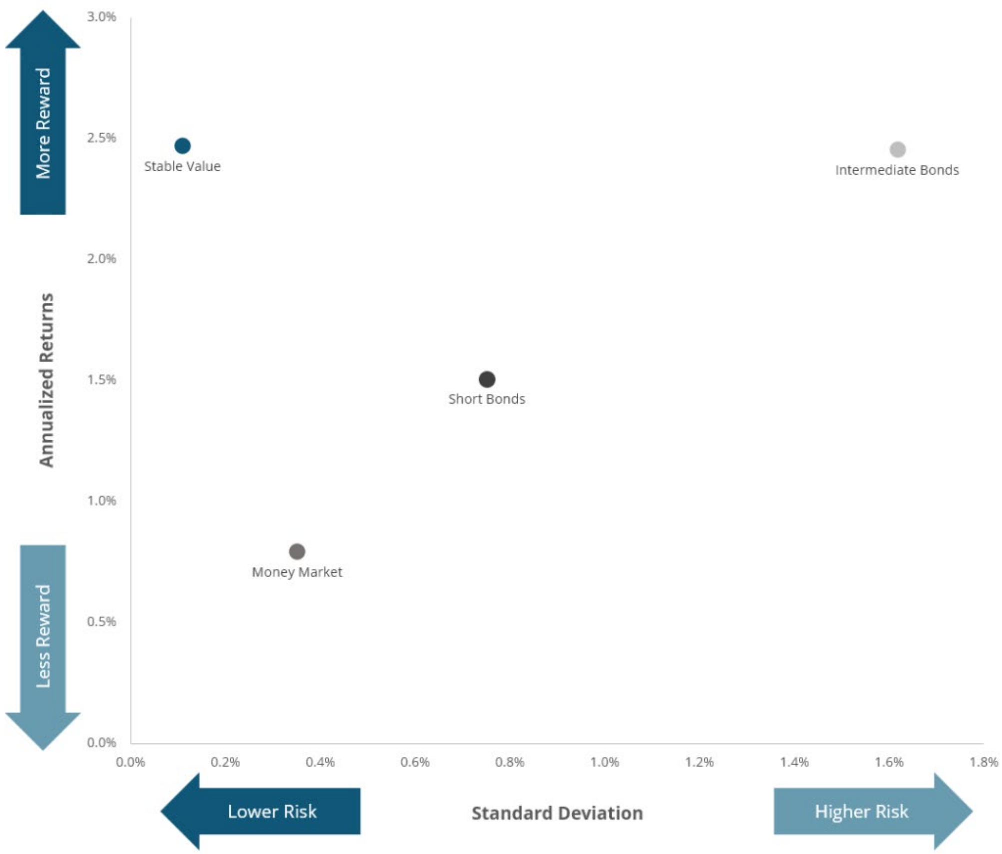
While the structure of and investments within stable value may vary, the important similarity in all stable value investments is the use of investment contracts, which are issued by banks and insurance companies. These contracts help deliver steady returns and allow participants to transact at their invested balance plus any accrued interest. This characteristic is what is known to stable value practitioners as benefit responsiveness.



The contracts that allow stable value to deliver these benefits are issued by insurance companies or banks and provide a financial commitment that participants are credited a minimum rate of interest (no less than 0%) and may withdraw their balances at contract value (their deposits plus accrued interest), rather than at the current market value of the assets backing the contract. Like a bond fund, stable value products are able to take advantage of the term premium, credit and convexity risk premiums, and the spread differential over similar duration U.S. Treasury bonds. Unlike bond funds, stable value products are also able to offer day-to-day principal preservation via the contractually set crediting rates provided by the stable value contracts. Through these features, stable value contracts provide day-to-day principal preservation with long-term rates of return consistent with those of bonds.

Stable value products benefit from unique accounting standards available to defined contribution savings plans that allow contract value accounting for stable value portfolios, rather than the mark-to-market accounting required for most other plan investments. This allows stable value products to amortize the market value gains and losses from the underlying fixed-income portfolios over time, thereby smoothing the returns earned by plan participants and insulating them from daily market volatility. This ability for stable value products to provide bond-like returns with very low return volatility provides investors a very attractive risk/return profile, as demonstrated by the following graph:

15 Year Risk/Return as of 3/31/2024



Takeaways

Stable value is one of the few products that combine a guarantee of principal with full participant liquidity, making it a uniquely effective tool for retirement income that has been highly valued by plan participants over time. This flexibility allows participants to adapt to changing needs and tailor their income plans to their specific circumstances while still being provided a predictable, low-risk income stream. Many participants are already using stable value as a retirement income solution, and providing more guidance and support for its continued use through regulatory changes would benefit many by enhancing a solution that exists in most plans without adding new products or complexity.

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Stable value is a well-established industry, not a new or untested product. It has been serving the defined contribution market since its inception, weathering numerous financial crises and consistently delivering on its promises to plan participants for decades.

We encourage the Council to recommend more widespread adoption of stable value as a tried and tested retirement income tool by expanding the Qualified Default Investment Alternative (QDIA) status for stable value investments to specific age cohorts and by recommending safe harbor status to existing QDIAs that utilize stable value for principal preservation near and in retirement.

We are happy to serve as a resource for any questions you may have about stable value and look forward to working with you to determine best practices for the decumulation phase of retirement.

Sincerely,

Zach Gieske, President
Stable Value Investment Association

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[i] Investment Company Institute. 2024. "The US Retirement Market, First Quarter 2024"; Stable Value Investment Association. 2024. "SVIA Stable Value Quarterly Characteristics Survey for 1Q2024".
[ii] Deloitte 2019 Defined Contribution Benchmarking Survey Report
[iii] Investment Company Institute. 2024. "The US Retirement Market, First Quarter 2024"; Stable Value Investment Association. 2024. "SVIA Stable Value Quarterly Characteristics Survey for 1Q2024".