DCALTA Defined Contribution Alternatives Association

IPA Institute for Portfolio Alternatives

Support Retirement Savings Modernization Act
May 12, 2022

We are writing to support the Retirement Savings Modernization Act (**the Act**), legislation that would vitally enhance the retirement security of U.S. defined contribution (**DC**) plan savers.

The Defined Contribution Alternatives Association (**DCALTA**) is the retirement industry's collective voice of plan sponsors, asset managers, and service providers seeking to enhance and secure DC plan saver's outcomes through education, research, and advocacy on the benefits of including alternative investments within a DC framework. We are dedicated to finding solutions to help overcome the market bias and operational impediments that may limit the use of alternative investments within DC plans.

The Institute for Portfolio Alternatives (**IPA**) is the leading trade organization representing asset managers, broker-dealers, registered investment advisers and other entities that provide portfolio diversifying investments to investors. For over 35 years, the IPA has advocated for increased investor access to alternative investment strategies with low correlation to equity markets, as part of a diversified portfolio. Such strategies include real estate, public and private credit and other real assets through investment vehicles such as non-listed real estate investment trusts and business development companies, closed-end funds and interval funds, among others.

Background

DC plan sponsors, typically employers, designate certain individuals to select a menu of investments that are made available to the plan's retirement savers. As fiduciaries, ERISA requires that they select investment options solely for the benefit of retirement savers under a "prudent person" standard, a duty of care that is the "highest known to the law." The fiduciary standard is uniformly applied to ERISA fiduciaries across DC plans and defined benefit (**DB**) plans, the latter typically known as pension plans. For decades, DB plan fiduciaries have satisfied this standard while investing in alternative investments that enhanced investment performance, increased diversification and mitigated portfolio risks. DC savers generally have not had access to alternative investments, due in part to litigation risk and because, until recently, fiduciaries had limited options to offer alternatives through multi-asset class vehicles managed by professional asset managers. As a result, DC plan participants have been excluded from the important benefits of alternative investments.

Benefits of Including Alternatives in DC Plan Options

Consistent with ERISA fiduciary duty protections, the Act provides for a modest allocation within a long-term focused, multi-asset fund option (such as a target date fund) on a DC plan menu through a well-diversified portfolio that includes alternative assets that are professionally managed and held within a prudent structure. For these reasons, and those described below, the Act will contribute significantly to the Nation's economic prosperity and benefit DC plan savers.

Level the Playing Field with DB plans and Public Employees

DC plan assets now exceed those of DB plans and form the foundation of retirement security for American workers.[1] The transition from DB plans to DC plans has not only impacted DC plan savers by shifting investment responsibility from the investment professionals and plan sponsors to plan participants, but it has simultaneously limited the asset classes they may use to generate investment returns needed for a secure retirement. For decades, most sophisticated DB plans invested in alternative asset classes such as real estate,

[1] The Investment Company Institute, June 2021 Report, https://www.ici.org/statistical-report/ret_21_q1.

infrastructure and private equity to optimize the risk/return in their portfolios.[2] Furthermore, retirement plan allocations to such alternatives have increased in DB plans from 7% to over 26% in the last 20 years.[3] However, for the reasons stated above, the current investment products available in DC plans typically lack an allocation to these alternative asset classes.[4] In short, the move from DB to DC shifted the financial responsibility to retirement savers while severely limiting the diversification tools needed to meet their retirement needs. This is fundamentally unfair and hurts American retirement security.

Most public sector employees already benefit from the inclusion of alternatives in their retirement plans. A full 85% of public DB plans incorporate alternatives.[5] Moreover, a growing number of public sector DC plans include alternatives by offering the option to invest in a mirror version of the DB plan asset allocation.[6] State and local plan sponsor clients of MissionSquare Retirement, the largest nonprofit retirement services company serving state and local government employees, already invest in alternatives through MissionSquare's target date funds. Public retirement plans, unlike defined contribution plans, are not however subject to the same regulatory scheme and resulting litigation risk that has restricted the growth of alternatives in DC plans.

Enhancing Retirement Income
Adding a modest allocation to alternative assets with a multi-asset fund, such as a target date fund, can materially enhance the retirement security of a DC plan saver by increasing annual income by 17%.[7] Participants would not only benefit from better investment performance, but they would also face lower volatility. Perhaps most importantly, these savers could reduce the risk of outliving their assets by almost half.[8]

Capture Growth
Today, much of the value creation in U.S. companies occurs at their private stage. Deep pools of private capital can now support the building of significant enterprises requiring massive amounts of investment, a sea change over recent years. In a related development, the number of U.S. publicly traded companies has declined precipitously over the last 25 years. Over the last 15 years, the equity value of U.S. private equity-backed companies has grown 2.5x faster than public company values.[9] DC plan savers limited to publicly traded assets may face an ever-shrinking set of investment options and be confronted with concentration risks, likely diminishing long term returns.

Parity with Defined Benefit Plans
For DB plans, when employers bear the risk of delivering a required amount of monthly income to retirees, the majority utilize a significant allocation to alternatives to meet their obligations.[10] Moreover, private equity, one of the main alternative assets, has historically been the best performing asset class on a net of fee basis. In

[2] American Investment Council 2021 Public Pension Study indicating that 85% of public pensions use private equity. https://www.investmentcouncil.org/wp-content/uploads/2021_pension_report.pdf.
[3] Towers Watson 2021 Global Pension Study. Note also that public defined benefit plans held an even higher proportion, at 28%, of their assets in alternatives as of 2020. https://publicplansdata.org/quick-facts/national/.
[4] Callan Institute March 2021 Defined Contribution Index. Analysis of 100+ large defined contribution plans with $350 billion in assets revealed an alternatives allocation of 0.1%. https://www.callan.com/dc-index/.
[5] American Investment Council.
[6] These public employee DC plans can offer an option to invest in a portfolio that mirrors the same employer's DB plan by "unitizing" the DB plan assets. The assets historically held by the DB plan are placed in a pool and interests in that pool can be owned by the DB plan itself or as one of the menu options for DC plan savers.
[7] Angela M. Antonelli, Center for Retirement Initiatives at Georgetown University, "The Evolution of Target Date Funds: Using Alternatives to Improve Retirement Plan Outcomes," June 2018.
[8] Ibid.
[9] Siblis Research, Preqin, December 2019. As of 2019, U.S. private equity NAV has grown 6.7x compared to U.S. public market capitalization's growth of 2.5x when compared to their original values in 2000.
[10] American Investment Council. Also, Pensions & Investments reports that the largest 200 DB corporate plans had an average asset mix of 11.9% in private equity and other alternative investments. https://researchcenter.pionline.com/uploads/datastore/plansponsor/2020-special-report.pdf.

dramatic contrast, less than 5% of employers offer DC plans savers the option to capture the return and diversification potential of alternative investments.[11]

Match Peer Country Defined Contribution Plans
While our DC plan savers generally cannot access alternatives, the DC plans of numerous other developed countries invest heavily in these assets. Moreover, most are investing through U.S. asset managers into U.S. alternative investments. For example, retirement savers in Australian Superannuation plans (DC plans) have been benefiting from access to U.S. private investments for decades and currently average a 19% allocation to alternatives.[12] Leveling this playing field is critical to ensuring the retirement security of American DC plan savers.

Bolster Infrastructure
Our country faces an alarming need for infrastructure investment, a rapidly growing part of alternative investment portfolios. These investments also typically provide an inflation hedge and regular source of income. Investing in alternatives assets such as U.S. real estate supports economic recovery, helping to stabilize commercial real estate markets following the COVID-19 pandemic, and provides much needed economic development in communities across the country, including multi-family and workforce housing. Facilitating DC plan investment in infrastructure will increase the capital directed toward this critical national priority while offering savers an appropriate risk adjusted return that enhances retirement security.

Support and Grow Small Businesses
Small firms and entrepreneurs lack access to the deep capital markets that finance the activities of large corporations. Minority-owned, women-owned and veteran-owned businesses were hit especially hard by the pandemic. Alternative investment strategies provide a critical source of capital to these firms and other small businesses, allowing them to expand and grow with terms more flexible than offered by bank loans.

Income Equality
Finally, DC plan investment in alternatives promotes income equality. For too long, alternatives have been the province of ultra-wealthy investors. A prudently structured and well diversified allocation to alternatives in DC plans can reduce this gap and enhance and protect the retirement security of American savers.

Conclusion

The Act reaffirms ERISA's high standard while reminding plan fiduciaries that consideration of alternative investments within a multi-asset vehicle choice on a DC plan menu can be appropriate. The Act also provides a framework to assist plan fiduciaries in evaluating multi-asset class investment options. Plan fiduciaries must engage in the same due diligence process and undertake the same type of analysis that they would in making any other investment decision. The Act provides savers with investment lineups with appropriate diversification tools that are the key tenets of modern portfolio theory.

For these reasons, we urge you to support the Act. If you have any questions, please do not hesitate to contact the undersigned.

DCALTA and IPA

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[11] State Street 2020 PE in Defined Contribution Plans and Collective Investment Trusts. On average, allocation to alternatives for DC is 2% versus DB's 17%. https://www.statestreet.com/ideas/articles/private-equity-dc-cit-plans.html
[12] Defined Contribution Alternatives Association and Institute for Private Capital 2019 Why Defined Contribution Plans Need Private Investments. The vast majority of Australian superannuation funds had alternative investments in the US, with at least a 15% exposure to private equity. https://cdn.northerntrust.com/pws/nt/documents/asset-servicing/why-defined-contribution-plans-need-private-investments.pdf.

Thank you very much for your consideration.

Respectfully submitted,

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