Potential Regulatory Changes

continued from page 12

simple," cautioned Brignac, arguing that it would, in fact, represent a very big shift for the money market industry, with challenges around recordkeeping on the part of buyers, sellers and intermediaries.

Stephen Kolocotronis, Fidelity Investments and Chair of the SVIA Government Relations Committee

A second alternative proposed by the SEC would keep stable net asset values for money market funds but create liquidity fees and redemption gates that would kick in if funds sustained substantial losses. Yet a third alternative would blend the first two approaches.

On an unrelated front, Brignac said, the SEC also is reviewing comments right now on a separate proposal that would require enhanced stress testing by money market funds, something she said the industry could easily handle.

While they are still looking at money market reform, regulators have already issued new rules for Short Term Investment Funds (STIFs), which are collective investment funds operated by banks. Like money market funds, they invest in short-term, high-quality, low-risk, fixed-income securities. Unlike money market funds, STIFs are available only to a bank's fiduciary customers, such as personal trusts and employee benefit plans, said Tim Keehan, vice president and senior counsel at the American Bankers Association's Center for Securities, Trusts and Investments. Also unlike money market funds, STIFs are not sold directly, but are typically provided as a component of another bank service. STIFs can serve, for example, as a sweep vehicle for the cash balance of another bank-maintained collective fund.

In July 2013, STIFs became subject to new rules issued by the Office of the Comptroller of the Currency. The rules are aimed at preventing any loss of principal in STIFs. Among other things, they require OCC-regulated banks to set and monitor limits on portfolio quality and diversification, stress test their portfolios at least monthly, and provide monthly disclosures about their portfolios to both fund participants and the OCC. The process has proved largely manual rather than automated, Keehan noted, requiring input from many departments within the banks that offer STIFs.

If the SEC goes forward with its proposed money market reforms, Keehan said the OCC may revisit its regulations for STIFs and consider whether more are needed.

Regulatory changes with STIFs and money market funds may make stable value even more of a go-to fund for retirement plan participants and plan sponsors looking for capital preservation as well as predictable, positive returns. However, even stable value was touched by the Dodd-Frank Act of 2010, despite its stellar performance in the financial crisis. Stable value was swept into Dodd-Frank's call for tighter oversight of derivatives, or what the Act calls "swaps," even though it seemed clear that legislators recognized that stable value was not a swap. As SVIA President Gina Mitchell pointed out, legislators simply ran out of time to change the bill's language, and were afraid that if they carved out stable value investment contracts, they would be overrun with other product requests. Instead, SVIA was able to achieve something no other group did: an exemption that required the CFTC and SEC to take a deliberative and thorough review of stable value investment contracts to determine if stable value was a swap, and if the Commissions determined stable value was a swap, whether it was in the public interest to exempt them from regulation as a swap. She noted that the Commissions have requested information from the public twice and have not yet completed their study of the subject. Even if they conclude that stable value contracts are swaps—a view the SVIA has contested—the regulators have the authority under Dodd-Frank to exempt stable value contracts from the new regulations. Until a final decision, the Act provides certainty that all stable value contracts are not swaps. SVIA

Wells Fargo Economist Sees US Consumer Spending in Seventh Inning of Rebound

By Randy Myers

The U.S. still hasn't recovered fully from the Great Recession of 2008-2009, but it's getting closer.

Jay Bryson, managing director and global economist for Wells Fargo, told participants at the 2013 SVIA Fall Forum that he foresees real U.S. gross domestic product growing by about 2.5 percent in 2014 and 2.75 percent in 2015. That would be down from the 3.2 percent growth rate averaged from 1992 through 2007, but up from the 2 percent or so averaged over the past few years. In short, it's sluggish but improving.

A key component of that forecast, Bryson says, is his expectation that consumer spending, which accounts for about two-thirds of GDP, will continue to gradually grow as well. Stronger gains in consumer spending would translate into stronger economic growth, of course, but several factors are working against that, Bryson said. Although many Americans have successfully deleveraged their personal balance sheets—shrunk their debt, in other words—relatively few are showing any sign of wanting to leverage up again. While more have been willing to take on car loans, the biggest driver of non-revolving credit over the last few years has been student loans. "That's not a sign that people want to leverage up, but that they are desperate to improve their earnings power," he said. In terms of consumers deleveraging, he said, "my sense is that we're in the seventh inning,"

The biggest potential for better-than-expected economic growth, Bryson suggested, lies in the chance that Americans begin saving less and spending more. But he said that isn't likely to happen

continued on page 14

US Consumer Spending in Seventh Inning of Rebound

continued from page 13

unless employment growth accelerates. While the country has been creating about 180,000 jobs per month on average, despite declining employment in the government sector, that rate would have to accelerate to 250,000 to 300,000 a month to make a real difference in savings rates, consumer spending and the economy.

Bryson said there is pent-up demand among consumers, especially for cars and houses. He noted that the average car on American highways is now 11 years old and that the country has been building just under a million new housing units per year. Just to keep pace with household formations, he said, we need to be building between 1.25 million and 1.5 million units annually.

Given this sluggish economic outlook, Bryson said he doesn't expect the Federal Reserve to begin raising short-term interest rates anytime soon, especially since inflation is running at about half the Fed's target rate of 2 percent. Besides, he noted, the Fed has specifically said it won't push short rates higher until unemployment hits 6.5 percent. The unemployment rate stood at 7.2 percent in September, and Bryson said he doesn't expect it to fall to 6.5 percent until early 2015.

Bryson said the Fed could act sooner to end its quantitative easing program aimed at holding down longer-term interest rates. That program involves the Fed buying $85 billion of bonds monthly, and the Fed has said it will begin to taper its bond buying once the economy looks stronger. Bryson said the earliest he expects the Fed to start tapering is December of this year, and that it might not begin until early 2014.

There are no guarantees the economy will continue its slow recovery without slipping back into a recession, of course. Bryson identified three potential threats, the first being an extraordinary event, such as a Middle East war that sends oil prices soaring to $200 a barrel, for example, or the federal government defaulting on its debt. Europe is the second, he said. It has only recently emerged from its second recession since the 2008 credit crisis and it continues to face troubling debt issues in some of its member countries.

The third threat is China, whose economic growth has slowed as it tries to transition from an economy based almost entirely on capital investment to one based more equally on capital spending and consumer spending. Bryson said his firm is in the camp that believes China's economy, which had been growing at 10 percent or more annually until recently, will make a "soft landing," growing in the 7 percent to 8 percent range over the next couple of years.

"To sum up, assuming we don't shoot ourselves in the head, and Europe and China don't blow up anytime soon, the outlook for the global economy is not bad," Bryson concluded. SVIA

Attendees at the Stable Value Investment Association Fall Forum 2013

How United Technologies Revamped its 401(k) Plan

By Randy Myers

Plenty of employers offer 401(k) plans because it seems like a good idea. Maybe the competition does it. Maybe employees like them. Perhaps the boss wants one.

United Technologies Corp., a global manufacturer that generated $57.7 billion in revenue in 2012, has bigger ambitions for its 401(k). As Kevin Hanney, the company's director of defined contribution plan portfolio investments, explained at the 2013 SVIA Fall Forum, one of United Technologies' goals is to create a secure retirement benefit for the vast majority of its employees for whom the 401(k) is their only retirement plan. But it also wants that plan to be flexible enough to provide opportunities for attractive investment returns for other workers using it to supplement a defined benefit plan. And, for those employees investing in the plan's stable value fund, they want to be sure that fund delivers a steady crediting rate that helps them to maintain their lifestyle in retirement.

To achieve those goals, United Technologies began thinking in 2006 about how it wanted to revamp its plan, Hanney said. In 2011, it streamlined the plan's investment menu, reducing the number of investment options, replacing actively managed equity funds with passively managed alternatives and reducing fees. In 2012, it introduced a lifetime income option within the plan, delivered through a target-date portfolio. For plan participants who choose that option, the retirement income is guaranteed by insurance contracts, which combine a guaranteed income floor with upside potential, liquidity, and optional joint life and beneficiary features. The total cost, at about 119 basis points, is about one-third what a similar income guarantee would cost in the retail marketplace, Hanney said.

The United Technologies plan uses custom target-date funds as the default investment option for participants who don't select investments on their own. While it still has a relatively streamlined menu of low-cost, core investment options for people who wish to construct their own investment portfolios, Hanney said it will be adding two additional options in 2014: a multi-strategy real asset fund and multi-manager risk parity fund.

"In a nutshell, what we are now offering through our 401(k) is a pension plan for the 21st century," Hanney said. "We embraced the idea that a 401(k) plan can be a pension plan." SVIA