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Consumer Morsel

The winding road to retirement

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Key talking points

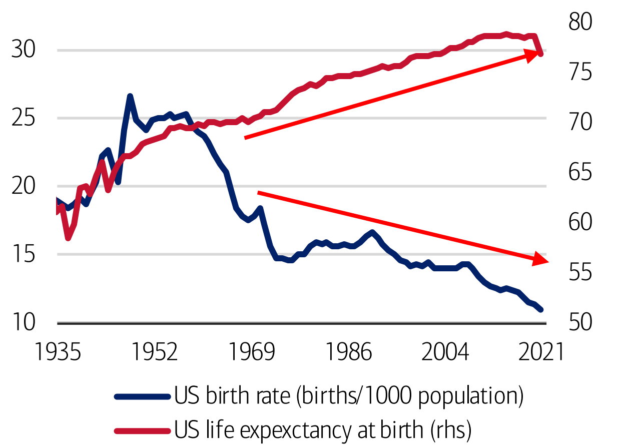
- In developed economies including the US the aging of the population places the public and private pension systems under stress.
- In the US a set of legislative proposals currently being discussed by lawmakers would make a number of changes to introduce more flexibility into private pensions and give people the scope to work longer.
- The inaugural BofA Global Research RIC Retirement Survey finds that many people, including Millennial and Gen Z, are already contemplating longer working lives.

Aging population implies retirement reforms are needed

Most developed economies face a similar challenge – their populations are aging and also living longer. Of course this is a positive outcome for individuals and their loved ones, but it poses the question of how society will find the resources to pay for an increasing share of their population who are retired.

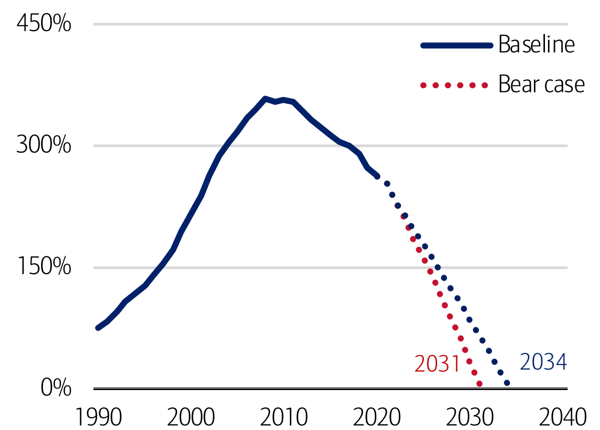
America's aging demographics – lower birth rates and higher life expectancy – mean that retirees will need more support from a shrinking labor force (Exhibit 1). This puts the social security system under strain as payments out increase while contributions decline. The Social Security Administration expects its trust fund to be depleted by 2034, and potentially as early as 2031 under adverse growth conditions (Exhibit 2). Moreover higher inflation could also accelerate cost of living adjustments, causing earlier trust fund insolvency.

Exhibit 1: Fewer births + longer lives = Social Security strain
US birth rates & life expectancy



Source: BofA Research Investment Committee, Haver, National Center for Health Statistics

Exhibit 2: The Social Security trust fund may be depleted by 2031
Solvency scenarios for the OASDI Trust Fund[1]



Source: BofA Research Investment Committee, Social Security Administration
[1]Old Age, Survivors, and Disability Insurance program

Increasing reliance on private pensions

Any path to the solvency for social security will likely involve reducing benefits, raising taxes, or raising the retirement age. Historically these have proven difficult areas for reform. Focus has therefore tended to shift to the other pillars of retirement funding: workplace pensions, private plans, and any continued work.

The retirement landscape has changed drastically in the past 40 year, with private "defined contribution" funds (e.g. 401k, 403b, IRA) now accounting for 70% of retirement assets, double their share in 1980. And through their pension decisions American households are now prime movers of financial markets. US retirement assets, worth $44.5 trillion at the end of 2021, typically amount to 69% of the total value of US bond and equity markets.

Proposals to improving flexibility in private pensions

With public solutions under pressure future retirement incomes will depend increasingly on private savings. This presents a challenge to policymakers to design reforms which potentially can help US households save for the future. The 'prize' though is potentially large though: a more stable domestic economy, better outcomes for families, and substantial inflows to financial markets.

In this context US lawmakers are discussing a major step to improve how private pensions work for workers and retirees. The Securing a Strong Retirement Act of 2022 ("SECURE 2.0"[1]) recently passed the House of Representatives by a vote of 414-to-5.

The SECURE 2.0 Act contains a number of key provisions:

- **Later Required Minimum Distribution (RMD)**: Today, savers must begin withdrawing funds from their retirement accounts at age 72 and take distributions every year thereafter. An investor with $100,000 in an IRA must, for example, withdraw $3,907 in the first year. A rise in mandatory age to 75 by 2032 is part of the House-passed bill.

- **Catch-up contribution for people aged 62-64**: Today, savers age 50 or older can make $6,500 in retirement contributions above the standard limit. SECURE 2.0 would increase those catch-up contribution levels by $3,500 (to $10k total) for those aged 62-64.

- **Small business 401(k)**: Under the Act, small employers would receive a 100% credit for any costs incurred when starting a retirement plan, plus up to $1000 in matching contribution funds per employee. Small businesses represent 98% of US companies, but less than 50% of those companies offer a retirement plan today. These measures could also bring about 21 million US workers into the retirement system per BofA Global Research calculations.

- **Part-time 401(k):** Part-time employees would become eligible to join retirement plans after two years of work, down from the existing requirement of three years; employers would be free to set even easier minimums.

Exhibit 3: SECURE 2.0 aims to reach the >50% of companies that lack retirement plans

Key SECURE 2.0 Act provisions and estimated market impact

Policy element	Policy change	Annual market impact
Later Required Minimum Distribution	Staring age raised from 72 to 75	**$14bn** in assets that would stay invested
Catch-up retirement contribution	Catch-up contribution limit raised from $6.5k to $10k for savers aged 62-64	**$44bn** in new flows assuming every person in the age cohort took advantage of the full catch-up increase
Small business 401(k)s	100% of costs covered to launch new plans and $1k credit per worker for employer matching contributions; all new plans auto-enroll	**$105bn** in new flows assuming a 6% contribution rate and conservative small business adoption rates
Part-time 401(k)s	Part-time employees get 401(k) programs after 2 years instead of 3*	**$18bn** in new potential flows

Source: BofA Research Investment Committee. Note: details for market impact calculations available on request.* As defined by DOL regulations.

BofA Research Investment Committee (RIC) Retirement Survey: What do Americans think?

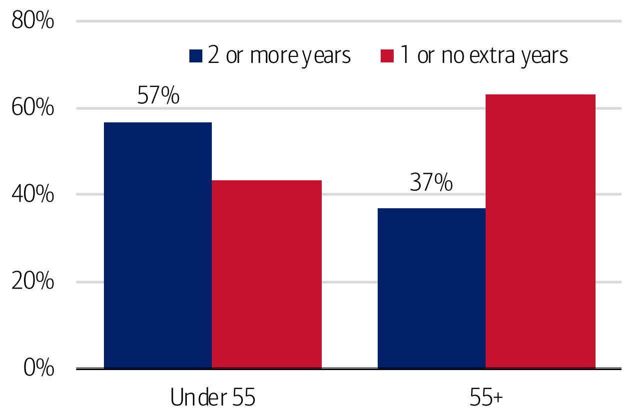
What do Americans make of these issues? BofA Global Research compiled its first RIC Retirement Survey this week. The survey asked 2,500 savers questions on their attitude and intentions around retirement. The sample is designed to match closely US Census demographics. The main findings of the survey were:

- **When asked if they would be willing to work longer to keep Social Security funded, nearly 6 in 10 people under 55 said they would work 2 years or more** (Exhibit 4).

[1] SECURE 2.0 builds on the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE) that was approved by the Senate in December 2019

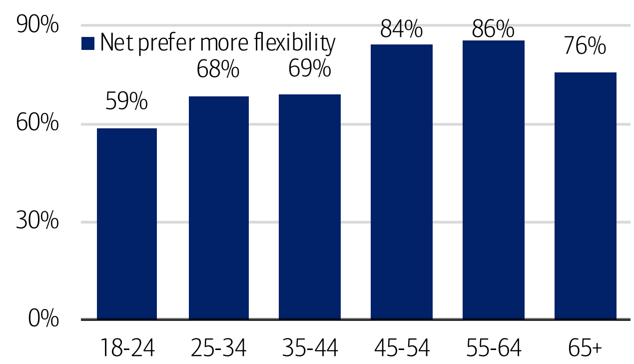
- On average, respondents said they're **already planning to work until 68 or 69**.
- **Millennials & Gen Z already plan to work & save longer**. Just 8% of those aged 35-44 plan to retire by 67.
- **14% of respondents aged 45-54 plan to retire later** now compared to 2019 despite record government stimulus programs.
- **75% of respondents favored more flexibility on retirement withdrawals**, suggesting strong support for SECURE 2.0 (Exhibit 5). The greatest support came from people 45 and older.
- If they were to increase their private retirement savings, equities would see the greatest flows (58%), followed by alternatives (42%), cash (40%), and bonds (33%).

Exhibit 4: 57% of people under 55 willing to work 2+ years
If it would keep Social Security funded for your retirement, would you be willing to work an extra:



Source: BofA Research Investment Committee, SurveyMonkey

Exhibit 5: 75% of savers want more retirement flexibility
Today, the IRS imposes penalties on people who don't withdraw enough from their retirement accounts after age 72. To secure your future, would you prefer more flexibility about when to spend your own savings?

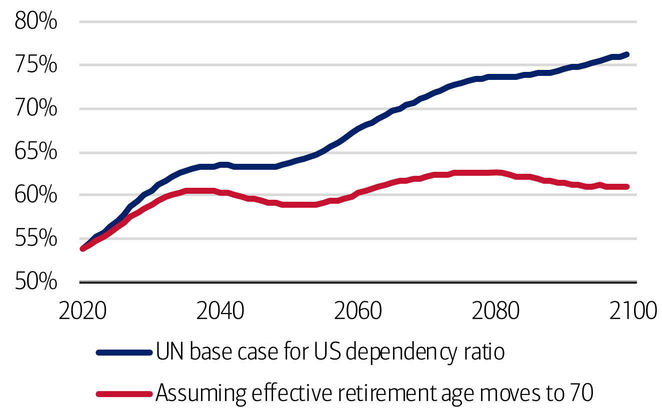


Source: BofA Research Investment Committee, SurveyMonkey

According to UN projections raising the retirement age to 70 would be sufficient to stabilize the ratio of dependents (children and those aged 65+) to workers (Exhibit 6). Given the BofA RIC Retirement survey results it suggests this is something that many savers are already contemplating.

If the survey findings are borne out by reality – and time will tell – they could also have big implications for labor market participation, tax revenue and right down to the goods and services that the economy will produce.

Exhibit 6: US dependency ratio steady with retirement age at 70[1]
US projected dependency ratio at different retirement ages



Source: BofA Research Investment Committee, Haver, United Nations
[1]100 x (Population (0-14) + Population (65+)) / Population (15-64)

Contributors:

David Tinsley

Senior Economist, Bank of America Institute

Sources:

BofA Global Research Research Investment Committee

Jared Woodard
BofA Global Research
Investment & ETF Strategist

John Glascock
BofA Global Research
Investment & ETF Strategist

Justin Devery
BofA Global Research
Portfolio Strategist

Derek Harris
BofA Global Research
Portfolio Strategist

Chris Flanagan
BofA Global Research
FI/MBS/CLO Strategist

Methodology

BofA RIC Retirement Survey methodology

In May, the BofA RIC surveyed 2,506 savers from a sample designed to match closely US Census demographics. The survey was completed between May 16, 2022 and May 18, 2022. Two-thirds of survey respondents were under 55 while more than 3/4th of respondents had incomes below $100,000.

Disclosures

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