K&L GATES

MEMO

By Email

TO: California Secure Choice Retirement Savings Investment Board

FROM: David E. Morse

DATE: March 17, 2016

RE: Overture's Final Report dated February 9, 2016

I have reviewed Overture's Final Report dated February 9, 2016. The Report lists several outstanding legal questions, which cannot be definitively answered at this point, but which should not prevent the Board from recommending that the Legislature proceed.

The Report recommends several Secure Choice Program options--such as limiting pre-retirement withdrawals, which are not allowed under the proposed ERISA safe harbor. The Board provided comments to the Department of Labor on these and other aspects of the proposed regulations, arguing for a less restrictive approach. When issued, the final regulations must be carefully reviewed to determine both whether any changes to the Program are required and whether any desired features can be added.

The precise the methodologies for complying with Patriot Act identification requirements should be addressed with potential recordkeepers during the RFP process. Generally, these requirements will be satisfied if the employer provides the recordkeeper with "good" information about itself (e.g., EIN, bank account and address) and on its eligible employees (e.g., name, address, DOB and SSN). Any problem, such as mismatches between name and SSN or invalid SSN, must be addressed by the affected person providing additional documentation to the recordkeeper.

The Report proposes two alternative investment approaches: (1) an asset allocation strategy using life cycle/target date funds; and (2) a "reserve fund" structured as a bond issued by a newly created California public authority in which IRA assets would be invested. As you know, we have recommended that the Board request the staff of the Securities and Exchange Commission ("SEC") to issue a "no-action" letter or other appropriate confirmation that the Program, particularly the "Secure Choice Trust" (the vehicle used to hold Program investments), is an instrumentality of the State of

California and therefore not subject to the federal securities laws. Without such confirmation, it is possible that Program would be considered an "investment company" under the Investment Company Act, and other aspects of the Program could be regulated under the federal securities laws. This would require registration with the SEC and significant reporting and disclosure obligations, which could make the Program considerably more expensive to operate. Thus, once the Board selects an investment structure and gives K&L Gates the go-ahead, we will begin the process by approaching the SEC staff. We hope that the Board will be joined by the Illinois and Oregon Boards in these efforts.

The Board should be aware that, while we believe a favorable outcome should be achievable, each of the alternative investment approaches may present some novel issues for the SEC staff.

Secure Choice Trust investments in target date/life cycle funds could present issues for the SEC staff, depending on the Board's preference for SEC-registered (off-the-shelf) or unregistered (custom or white label) investment vehicles (or both). Investments in SEC-registered target date/life cycle mutual funds generally should not present additional issues. Unregistered target date/life cycle funds such as collective investment funds maintained by banks or insurance company separate accounts, on the other hand, generally are available as investments only for tax-qualified 401(k) and other retirement plans but not IRAs. Thus, if the Board wishes to have the Secure Choice Trust invest in unregistered bank or insurance company funds, the SEC staff will need to consider (and be persuaded that) the Secure Choice Trust should be considered an eligible participant in such vehicles.

Regarding the reserve fund, we expect that it may take the staff significant additional time to understand and get comfortable with the reserve fund concept (as compared to investments in more familiar target date/life cycle funds). Because Illinois and Oregon are expected to offer only target date/life cycle funds, any added legal costs associated with the reserve would be borne entirely by California. Also, the reserve fund will require legal work in establishing the public authority and preparing the appropriate documents.

The reserve fund approach also requires several unique inter-cohort balancing issues to be addressed by the Board or in the enabling legislation. For example, some early participants and short term participants may not benefit from the reserve and could even experience reduced returns in good market years when "excess" returns are funneled to the reserve fund. Others, who participate during bad years, may benefit from the reserve accumulated by previous investors. In addition, if the reserve fund becomes sizable, the Board and the State Government may face pressure to "break open" the

reserve for immediate allocation or, conceivably, some State purpose outside the Secure Choice Program. If the Board recommends the reserve fund, it should consider whether it wishes to limit the flexibility of the future board which will be responsible for the Program by asking the Legislature to hard-wire the reserve fund's operating rules for accumulating and applying the reserve in the Secure Choice enabling legislation. The reserve fund is not legally superior or inferior to the target date/life cycle approach; nevertheless, the Board should be aware of these issues in making its decision.

Finally, it is likely that various legal and administrative issues will remain open even after the Board makes its final recommendations. Thus, it is critical to the success of the California Secure Choice Program that the Board's recommendations and the eventual enabling legislation build in significant flexibility to adjust and readjust the Program as circumstances change.

Please let me know if you have any questions or would like to discuss further.

cc: Grant Boyken
Christina Elliott
William Wade