CALIFORNIA SECURE CHOICE RETIREMENT SAVINGS INVESTMENT BOARD

915 Capitol Mall, Room 110
Sacramento, CA 95814
p (916) 651-7427
f (916) 651-3125
www.treasurer.ca.gov/scib

MEMBERS

JOHN CHIANG, CHAIRMAN
State Treasurer

BETTY YEE
State Controller

MICHAEL COHEN
Director of Finance

EDWARD J. DE LA ROSA
Senate Committee on Rules Appointee

YVONNE R. WALKER
Speaker of the Assembly Appointee

HEATHER HOOPER
Governor Appointee

WILLIAM SOKOL
Governor Appointee

MARTY MORGENSTERN
Governor Appointee

CYNTHIA POLLARD
Governor Appointee

ACTING EXECUTIVE DIRECTOR
Christina Elliott

March 28, 2016

Honorable Kevin de León
President pro Tempore of the California State Senate
State Capitol, Room 205
Sacramento, CA 95814

Subject: California Secure Choice Retirement Savings Investment Board Recommendations for Legislation Implementing the California Secure Choice Retirement Savings Program

Dear President pro Tempore de León:

In accordance with Government Code Section 100040, the California Secure Choice Retirement Savings Investment Board (Board) finds the Secure Choice Retirement Savings Program (Secure Choice or Program) to be a feasible, sustainable, and legally permissible program that could help 6.8 million workers start saving for their future.

Since inception in 2012, the Board raised private money from various groups and hired consultants to conduct a market analysis and feasibility study with corresponding program design features. With the private funding, the Board also hired outside legal counsel to provide legal analysis to ensure the Program and all impacted employers would not be considered an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA). The legal analysis also focused on the legal viability of the Program as the market research was being conducted.

President Obama directed U.S. Secretary of Labor, Thomas E. Perez, to issue regulations that would clarify how states could move forward with retirement plans for private sector workers without being preempted by the Employee Retirement Income Security Act (ERISA). In the fall of 2015, the U.S. Department of Labor released proposed rules which created a safe harbor from ERISA for savings arrangements established by states for non-governmental employees. The proposed rule allows programs like Secure Choice to move forward without ERISA preemption. The catalyst for this safe harbor is the employer mandate. Employers acting pursuant to a state mandate to enroll their employees into Secure Choice would have no liability or fiduciary duty for the plan. This was an exciting win for the Program and for other states interested in Secure

Choice-type programs as we have been given the green light to auto-enroll workers into an Individual Retirement Account (IRA).

The key findings of the market analysis and feasibility study are:

- About 6.8 million workers are potentially eligible for the California Secure Choice Retirement Savings Program

- Likely participation rates are sufficient to enable the Program to achieve broad coverage well above the minimum threshold for financial sustainability

- Eligible participants in California are equally comfortable with a 3% or 5% default contribution rate. The vast majority of likely participants are also comfortable with auto-escalation in 1% increments up to 10%

- Given its inherent portability, the Program should have a lower incidence of rollovers and cash-outs than employer-sponsored 401(k) plans, which often force workers with low balances to close their accounts

Based on the findings of the final report, stakeholder feedback, and public comment, the Board recommends that legislative language, consistent with the following principles be adopted to provide the Board sufficient flexibility, including if necessary repealing statutory language impeding such flexibility, so that it can shape the program as it develops and reacts to changes in the market, while protecting workers' contributions and limiting employer burdens. The Board recommends that Senate Bill 1234 allow the Board to:

- Establish managed accounts that would be invested in U.S. Treasuries or similarly safe investments within the first three years of the program

    - The Board recognizes there are legal and practical hurdles to overcome before the various investment options could be implemented. Within the first three years, the Board should begin to develop investment options that address risk-sharing and smoothing of market losses and gains at inception. Options could include but not be limited to custom pooled, professionally managed funds that minimize management costs and fees, the creation of a reserve fund, or the establishment of investment products

- The Board will conduct an annual peer review to compare California Secure Choice funds with similar funds on performance and fees

- The Board will be required to seek to minimize participant fees

- Implement program features that provide maximum possible income replacement in an IRA based environment

    - The Board will establish an initial automatic contribution rate of between 2% and 5% of salary

  - The Board may implement automatic escalation of participants' contribution rates up to 10% of salary with the option for participants to stop automatic escalation and change their contribution rates

  - The Board and its contracted administrators and consultants shall have a fiduciary duty to the participants of the Program. Investment policy decisions, including asset allocation and investment options, will be entrusted with the Board subject to fiduciary duties

- Include quasi-public and quasi-private workers to be enrolled if found legally permissible

- Conduct communication and education on the Program, including the inherent risks of its investment strategy or strategies, the purposes and inherent risks of investing in U.S. Treasuries or similar safe investment options for the first three years of the Program, therefore the state does not have liability for the investment performance or payment of benefits to Secure Choice participants

- Determine the default payout method to retirees

- Clearly define "ministerial duties" expected of employers in the implementation of the program and limit liability for all employers if an employer inadvertently provides more than ministerial duties

- Fully determine all necessary costs associated with outreach, customer service, enforcement, Board staffing and consultant costs, and all other costs necessary for the administration of the program and to ensure all investment options are appropriated considered by the Board for the Program

- Make determinations on how to structure the Program to ensure the state is prohibited from incurring liabilities associated with administering the Program

The board acknowledges the concerns raised by business associations and will partner with employer representatives as it creates the administrative structure to ensure their concerns are addressed. The business community is a vital stakeholder in this work and we will ensure they are partners with us as we form the outreach and education to California businesses. The education campaign to California's employers will be a top priority as we understand that employers must not hold any liability. Additionally, it must be clear both in statute and as part of the education campaign that the State of California has no liability for the program or its investments.

We encourage the Legislature and the Governor to move forward with Secure Choice. While the preliminary work for this endeavor has come to a close, there is much more to do. We must continue to collaborate with members of the Legislature, workers, businesses and other stakeholders to improve the Program as it develops. There are some outstanding legal questions with respect to how this fund would be treated by the Securities and Exchange Commission. However, these issues will not thwart the ability of the Board to implement the Program.

California continues to be a thought leader on this front and believes that every worker deserves the option to retire with dignity. Your support is paramount to the Board's ability to lay the groundwork for the Program. We hope you join in supporting this great endeavor.

Respectfully submitted,

The California Secure Choice Retirement Savings Investment Board

Members:

John Chiang, Chair
California State Treasurer

Betty T. Yee
California State Controller

Michael Cohen
California Director of Finance

Edward J. De La Rosa
Senate Committee on Rules Appointee

Yvonne R. Walker
Speaker of the Assembly Appointee

Cynthia Pollard
Governor Appointee

William Sokol
Governor Appointee

Marty Morgenstern
Governor Appointee

Heather Hooper
Governor Appointee