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November 15, 2013

Mr. Grant Boyken
California Secure Choice Retirement Savings Program
915 Capitol Mall, Room 110
Sacramento, CA 95814

Re: Questions Relating to Secure Choice RFI 13-01

Dear Mr. Boyken,

The American Society of Pension Professionals & Actuaries ("ASPPA") is pleased to respond to the Request for Information ("RFI") regarding the California Secure Choice Retirement Savings Program (the "Program").

ASPPA is an organization representing more than 16,000 retirement plan professionals nationwide. Our members provide consulting and administrative services for qualified retirement plans covering millions of American workers. Our members are retirement professionals of all disciplines, including: consultants, administrators, actuaries, accountants, attorneys, and investment professionals that are united by a common dedication to the private employer-based retirement system.

ASPPA has consistently and actively supported proposals to expand retirement plan coverage. This has included auto-enrollment IRA[1] proposals supported by the Obama Administration that would require employers to offer payroll reduction savings at work through private sector providers while encouraging employers to set up private sector qualified retirement plans, as well as similar state-based proposals such as the California Secure Choice Retirement Savings Trust Act, as enacted in 2012.

Per the guidance provided by the RFI, ASPPA will answer only those questions relevant to our organization's expertise and experience. These questions and responses will be listed below.

Plan Structure

Question 1: What type of plan structure would you recommend to best meet the statutory goals and objectives for the Program?

ASPPA recommends that the program be structured as a state-based automatic enrollment IRA arrangement ("auto-IRA") similar to the federal auto-IRA proposal offered by Representative Richard Neal (D-MA, 1st), and included in the Obama Administration's latest budget. The auto-

[1] "IRA" means either an individual retirement account, as defined under Section 408(a) of the Internal Revenue Code of 1986 ("IRC"), or an individual retirement annuity, as defined under IRC Section 408(b).

IRA structure is a good fit for states because of a desire to avoid fiduciary obligations under the Employee Retirement Income Security Act of 1974 ("ERISA").

Unlike auto-IRA arrangements, a state-run qualified retirement plan, whether a 401(k)-type plan or a defined benefit plan, would make the state subject to ERISA fiduciary liability. The state would become a fiduciary on all plans that are covered by their program because the state would be selecting the investments and presumably serving as plan administrator. There are also other risks associated with non-compliance with federal rules under both ERISA and the IRC, such as a loss of expected tax deductions for employers who adopt the plan if any mistake is made, and penalties if required disclosures are not completed on a timely basis. These rules are important – they are designed to protect rank and file workers. They are also complicated, time consuming to administer, and generally apply separately to each adopting employer. Although the state could contract the fulfillment of these ERISA and IRC responsibilities to an outside vendor, the state would retain ultimate legal responsibility for the plans' administration and operation.

Using auto-IRA arrangements as the basis for a state proposal avoids many of the complications of a qualified retirement plan. A state proposal requiring employers of a certain size that do not already sponsor a qualified retirement plan to auto-enroll employees into an IRA program allows for expansion of payroll-deduction retirement savings without placing additional responsibility and liability on the small business owners that are most likely to be affected by a state proposal, as well as on the state itself.

Plan Design and Features

Questions 8 & 9: What would you recommend as the automatic, or "default," contribution level for participants who do not opt out, but who do not make an affirmative decision to contribute at a higher rate than the default rate? What options, if any, would you recommend for an automatic escalation feature that increases participants' contributions over time?

ASPPA recommends that the automatic, or "default," contribution level for a participant under the auto-IRA Program be at least 3% of a participant's compensation, and that the Program also include an automatic escalation feature that increases a participant's contributions over time to a maximum of 15% of compensation. A participant should have the ability to change this default rate at elected periods, but no less than four times per year.

The auto-IRA design could include gradual increases in the minimum automatic enrollment contribution rates so that when the program first becomes effective, a participant is not surprised by any drastic changes in take home pay. For instance, the minimum automatic enrollment contribution rates could be gradually increased from 3% to 6% of compensation over the years immediately following the establishment of the Program. .

It should be noted that the Employee Benefits Research Institute ("EBRI") modeled the impact of increasing default deferral rates in qualified retirement plans with automatic enrollment from the typical plan design of 3% of participant compensation to 6% of participant of compensation.[2]

[2] Jack VanDerhei, *Increasing Default Deferral Rates in Automatic Enrollment 401(k) Plans: The Impact on Retirement Savings Success in Plans with Automatic Escalation*, Employee Benefits Research Institute (2012) available at http://www.ebri.org/pdf/notespdf/EBRI_Notes_09_Sept-12.HCS-AE.pdf

EBRI found that in 2012 more than 25% of those in the lowest-income quartile who had previously not been successful under actual plan default contribution rates would now attain retirement income adequacy as a result of raising the auto-deferral rate to 6%.

ASPPA recognizes that many financial experts believe that a default rate of 3% of a participant's compensation is far too low to generate sufficient assets for a comfortable retirement. However, with an automatic escalation feature that increases a participant's contributions to the auto-IRA account by 1% of pay per year it does not matter as much where the participant starts but rather where the participant finishes.

Question 10: Are there any other plan design features that should be included (or eliminated) to ensure the plan meets the goals and objectives of the Program?

ASPPA recommends that the Program ensure the portability of the auto-IRA benefits by allowing participants to transfer their assets directly to another retirement savings vehicle at any time.

Under current Internal Revenue Service ("IRS") rules, an individual is permitted to transfer funds between the same types of retirement accounts without taking a distribution whenever an individual wants without any tax penalty, a transaction known as a "trustee-to-trustee" transfer. Individuals who wish to move funds between two types of retirement accounts by receiving a distribution from one account then depositing the funds to another account, a transaction known as a "rollover," must do so within 60 days of receiving the funds and can only move funds from the same IRA once every 12 months, otherwise those funds may be subject to federal income tax. The availability of direct transfers allows employers to transmit all payroll deductions to the same provider without binding employees to investing with that same provider. Once a deposit is made to the employer's selected provider, the employee could simply transfer it to the IRA of their choice.[3]

Question 11: What plan design elements would you recommend to minimize pre-retirement "leakage"?

To minimize pre-retirement leakage, it would be tempting to simply prohibit distributions from the Program until retirement age. However, because other available IRA vehicles provide more flexibility, and because employers would bear the brunt of complaints from participating employees who are denied access to moneys in the accounts, such a prohibition may serve mainly to make the Program unattractive to employers and employees, and be counter-productive. ***ASPPA recommends*** that participant education be provided on the advantages of saving *for retirement,* as well as the tax penalties incurred by early withdrawal, and that direct transfers to another retirement vehicle be available to avoid the need to take a cash distribution in order to move savings to another tax-preferred account.

[3] In fact, Department of Labor ("DOL") guidance regarding operating a payroll deduction IRA program without becoming covered by ERISA requires an employer to fully disclose any restrictions on an employee's ability to transfer or rollover contributions to another IRA in advance of the employee's decision to participate if the employer is transmitting contributions to a limited number of providers. (DOL Interpretive Bulletin 99-1) This guidance is discussed more fully in the response to Question 18.

Costs and Fees

Question 14: How would you recommend the Board ensure transparency of fee and expense information available to the Board and Secure Choice participants including transparency of service providers' relationships or potential conflicts that may increase costs and/or conflict with the interests of plan participants?

ASPPA recommends that the Board require service providers of the auto-IRA Program to make reasonable fee disclosures to the Board and auto-IRA Program participants in order to be granted authority to provide services to the Program's auto-IRAs. These disclosures should include an advance notice of available investment options offered by the service provider, a chart comparing the fees of the available investment options offered by the service provider, a categorization of any charges applicable to the auto-IRA, a description of the purpose of the charges, and information on the past performance of the various investment options offered by the service provider.

Administrative Issues

Question 15: What are your recommendations for identifying, and disseminating information to eligible employers and employees?

As discussed in Question 18, DOL guidance regarding operating a payroll deduction IRA program without becoming covered by ERISA should be followed closely in determining what information is disseminated through the employer and what information is provided directly to participating employees by the Program. ***ASPPA recommends*** that electronic delivery of information be the default means of communication, to allow for more engagement and interaction on the part of participants, and reduce operational costs. However, any participant that wants to receive disclosures in paper form should be permitted to do so.

Question 16 & 17: What are your recommendations for managing enrollment, the receipt and recordkeeping of employee payroll contributions and transactions, and managing rollovers in and out of Program accounts? Do you have any particular concerns about, or anticipate any significant challenges with administering the Program?

ASPPA strongly recommends that the private sector manage and administer the auto-IRA Program. In fact, the private sector role is critical in this endeavor. An entire pension industry of record keepers, financial services companies, consulting firms, and other professional firms, is already in place and in some cases are already maintaining payroll deduction accounts that function exactly like the proposed auto-IRA arrangement. The number of small accounts established under the proposed auto-IRA Program would present special challenges. The majority of these accounts are expected to have small balances and it is critical that employee savings not be eaten up by fees. However, using collective investment and uniform administrative processes allows providers to keep fees low. Competition among private sector firms will drive innovation resulting in better services for employees. And importantly, it is private sector providers that will be encouraging employers that are offering auto-IRA arrangements to step up to a more robust arrangement that includes employer contributions.

Legal Issues

Question 18: What approach would you recommend to demonstrate the Program is not subject to ERISA and that Secure Choice accounts would qualify for favorable federal income tax treatment generally granted IRAs?

Demonstrating the Program is not subject to ERISA is dependent on assuring that the accounts are in fact IRAs, and following the guidance the DOL has provided for assuring payroll deduction IRA arrangements are not subject to Title I of ERISA.

Section 100008 of the California Secure Choice Retirement Savings Trust Act (the "Act") specifically states that the "Program shall include, as determined by the board, one or more payroll deposit IRA arrangements." Section 100000(e) of the Act defines IRA as "an individual retirement account or individual retirement annuity under Section 408(a) or 408(b) of [the IRC]." Section 100043 of the Act states that the "board shall not implement the program if the IRA arrangements offered fail to qualify for the favorable federal income tax treatment ordinarily accorded to IRAs under the [IRC], or if it is determined that the program is an employee benefit plan under [ERISA]." Section 100044 of the Act states that "This title shall be construed liberally in order to effectuate its legislative intent. The purposes of this title and all of its provisions with respect to the powers granted shall be broadly interpreted to effectuate that intent and purposes and not as to any limitation of powers." IRC Section 408(a)(2) requires that the trustee of an IRA must be a bank "or such other person who demonstrates to the satisfaction for the Secretary that the manner in which such other person will administer the trust will be consistent with the requirements of this section". Thus, unless a bank is appointed to serve as trustee of the Program, the Trustees will have to request approval of the Secretary of the Treasury to operate as the trustee of an IRA arrangement. However, given the clear intent, and the ability to liberally construe the provisions to effectuate that intent, it is difficult to argue that the accounts would not be IRAs, and qualify for the tax treatment afforded IRAs.

Given the Program will consist of IRAs, the path to avoiding being subject to ERISA has been laid out in DOL guidance. Section 2510.3-2(d) of the regulations issued by the DOL sets forth the following requirements that an IRA must satisfy in order to not be considered an "employee pension benefit plan" or a "pension plan" subject to Title I of ERISA:

- No contributions are made by the employer
- Participation is completely voluntary for employees
- The sole involvement of the employer is without endorsement to permit the sponsor to publicize the program to employees, to collect contributions through payroll deductions, and to remit them to the sponsor; and
- The employer receives no consideration in the form of cash or otherwise, other than reasonable compensation for services actually rendered in connection with payroll deductions.

In order to "encourage retirement savings" and summarized and restate "its views on employer involvement in providing voluntary payroll deduction systems for contributions to IRAs" the DOL issued Interpretive Bulletin 99-1 (29 CFR 2509.99-1) on June 18, 1999. This bulletin "clarifies the circumstances under which an employer may facilitate employees' voluntary contributions to IRAs by providing an IRA payroll deduction program without thereby inadvertently establishing or maintaining an employee benefit pension plan within the scope of section 3(2) of ERISA."

Note that Section 100012(k) of the Act provides that that board shall have the authority to allow "participating employers to make their own contributions to their employees' [IRAs], provided that the contributions would be permitted under the [IRC] and would not cause the program to be treated as an employee benefit plan under [ERISA]." Because Section 2510.3-2(d)(1)(i) of the DOL's regulations, specifically prohibits employer contributions to an IRA that is not subject to Title I of ERISA, the authority given to the board in Section 100012(k) cannot be exercised.

ASPPA strongly recommends that the board strictly comply with the rules set forth by the DOL in DOL Regulation Section 2510.3-2(d) and Interpretive Bulletin 99-1 in order to ensure that the auto-IRA arrangements contemplated by the Program do not become employee pension benefit plans subject to Title I of ERISA. To that end, we suggest that references to employer contributions be struck when enabling legislation is enacted. Furthermore, any educational materials distributed to employees through the employers must not make the employer appear to be endorsing the Program. Interpretive Bulletin 99-1 includes guidance on this issue for payroll deduction IRA arrangements.

Question 19: What further statutes and/or regulations would you recommend be enacted in order to strengthen the legal basis for this retirement savings program?

ASPPA is not aware of further statutes or regulations which would be necessary to enact in order to strengthen the legal basis for the Program. However, a change to federal law to eliminate roadblocks to establishing an IRA for an individual who is defaulted into the program would help streamline the implementation of an auto-IRA arrangement. For example, section 2(d)(1)(B) of H.R. 2035, introduced by Representative Richard Neal (D-MA) in the 113th Congress, would address this concern by treating the auto-IRAs required by his legislation as accounts established under an ERISA employee benefit plan *solely* for purposes of the customer identification program established under section 5318(l) of title 31 of the U.S. Code.

Establishing a Retirement Investment Clearinghouse

Question 20: Please provide your assessment as to whether there would, or would not, be sufficient interest from vendors to establish an online Retirement Investments Clearinghouse.

ASPPA applauds that the Program encourages private sector involvement through an online clearinghouse where employers will be able to identify private sector providers that are offering auto-IRA arrangements and is confident there will be sufficient interest. As mentioned above, the private sector is eager and willing to participate in providing retirement plan solutions for businesses that currently do not offer retirement plans for their employees. The Retirement Investment Clearinghouse provides a distribution tool for these private sector companies to use in order to increase retirement plan coverage in the workplace.

Question 21: How would you recommend the Board establish a process to register participants and operate the clearinghouse effectively, efficiently, and in a manner that eliminates or reduces any liability on the part of the Board associated with registering participants and operating the clearinghouse?

ASPPA recommends that the Board use the thorough and extensive information gathering requirements for vendors who wish to participate in the clearinghouse provided in the Act to reduce and/or eliminate any liability on the part of the Board associated with registering participants and operating the clearinghouse. Proper enforcement of Section 100020 of the Act should shield the State from liability.