

PAi Overview

For thirty years, PAi has partnered with advocacy groups, financial services leaders and retirement industry leaders to raise awareness of the critical gap in individuals' retirement savings versus retirement needs. Through these partnerships, we have developed educational programs and a suite of innovative solutions to promote participant savings through employers. PAi specializes in small business retirement plan record-keeping and administration. We deliver our services to small employers through large branded organizations such as banks, b2b retailers and wholesalers, insurance companies, mutual fund companies and brokerage firms. We currently support nearly 15,000 small business retirement plans representing approximately \$4 billion in assets under administration. The PAi service model is designed to provide a comprehensive retirement solution with high-touch and high-tech customer care, all at affordable fees. Solving the retirement readiness issue requires an inclusive strategy and teamwork. To that end, we have created the ability to connect employers, employees, payroll companies, banks, investment companies and government agencies to facilitate success for each individual worker. Our company values are Care, Know and Do. Building large retirement systems that serve small business employees is our specialty. Thank you for the opportunity to contribute.

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Plan Structure

1. What type of plan structure would you recommend to best meet the statutory goals and objectives for the Program, which include simplicity, ease of administration for employers, preservation of principal and portability of benefits (e.g., pooled fund with guaranteed interest credited to individual accounts on a regular basis that utilizes a gain and loss reserve? Individually held IRA accounts with a variety of funds from which participants could choose? (Something else altogether?)

PAi: The "structure of the plan" and the "structure of the investment choices within the plan" are two separate and distinct choices that the current retirement industry supports very well. We believe the structure of the California Secure Choice "Plan" should be a very simple execution of a payroll deduction IRA. We feel there is an excellent opportunity to advance retirement readiness if the "structure of the investment choices" is made available to small employers who wish to have an employer funded plan with higher contributions for all employees.

“Simplicity” has different meanings for different audiences. The retirement marketplace has evolved to serve simplicity to each of those audiences as is meaningful to them. For employers with a plan, simplicity means ease of administration. The connected nature of the payroll process makes that very simple to achieve and serve all but the smallest percentage of employers who may still do payroll on a manual basis.

For employees/participants, simplicity means a communication style and method that fits their lives. For some, this includes heavy emphasis on smart phones, a website, or a carefully constructed electronic “conversation”, and for others it may continue to be paper statements. We can confidently say, that for all, a call center to “connect to” is a necessity. The content of that communication can be tailored by the individual from “Am I doing okay?” to “How did my fund do vs. other funds and world indices?” – from taking care of the average participant to addressing the informational needs of the investment hobbyist.

Investment choices and structures should be similarly individual in nature. Today’s technology makes it possible within one program to allow individual direction, professional portfolio solutions, stable value and/or guaranteed/insured products. While the initial rollout of the program could be limited to a few options to ease the implementation communication, there are plenty of proactive communication strategies that should be tailored to suit the individual participant’s needs. A comprehensive communication plan would integrate public messaging, strategic use of social media, online and Brainshark-type videos, in-person events through community colleges and education organizations, and interactive games.

In today’s marketplace you can “simplify” the program by making it fit the individuals in the audience it serves.

Investment Options

2. What investments would you recommend to best meet the goals and objectives of the Program, both in terms of the types of funds and underlying assets, and the style of management (i.e., active vs. passive)?

PAi: We do recommend more than one investment option if the Program’s goals are clearly stated to support it, however, we are in a position to work with any number of investment solutions. A bullet point in the RFI states “The plan should be designed to preserve the safety of principal and provide a stable and low-risk rate of return.” Employees participating in the program will have varied investment needs and risk tolerances. While an income preservation option is certainly necessary for some investors, it may be imprudent for investors with longer investment horizons who are comfortable with more risk. The options, however, must adhere to the investment policy set by the board. If the goal were to provide options, we would recommend a series of portfolios that allow participants to choose a path that matches their lifestyle, either through individual direction or the use of a service provider who monitors their journey and directs the appropriate solutions from among the choices.

3. If you recommend more than one investment option, what would you recommend as the “default,” or automatic, option that would be chosen for participants who do not make an affirmative decision?

PAi: To the extent that the program allows for “choice”, our preferred default option would be a portfolio appropriate to the participant’s desired level of risk, encompassing both their emotional tolerance for market swings and their need to take the type of risk that meets their retirement objectives.

Please keep in mind, that to the extent the program has been talked about to date, it has appeared to be a single capital preservation oriented investment offering with a gain/loss reserve. Although the laws under which the Program was created permits a wide variety of investments, it is unclear whether there is an intent to offer options that diverge from the primary objective of capital preservation. The success of this program is dependent upon clearly aligned communications.

4. Would you recommend including any insured interest or insured income products? Why or why not? What are the advantages and disadvantages of these products in terms of performance, risks, cost and transparency?

PAi: In today’s uncertain markets, there is a high demand for insured interest or insured income products. They can be designed to maximize transparency and minimize costs (actuarial and administrative). We would recommend that this type of option be included and monitored appropriately..

5. Would you recommend the Program provide a lifelong stream of guaranteed income? If so, how would you convert retirement savings into a lifelong retirement income stream, and what investment product would you recommend to accomplish this objective?

PAi: : We would recommend that the Program allow participants to choose a lifelong stream of guaranteed income. There are a number of high quality products and providers who can tailor a solution to an individuals needs. Great care must be given to the communication around products like these as they behave considerably differently than other non-guaranteed investment options. Finally, guaranteed products are often successfully introduced near the point where a participant converts from the accumulation phase to the decumulation phase of their retirement journey. We also recommend that participants be allowed to make temporary or partial annuitized payment and then product decisions. Lump sum payment options can lead to very bad outcomes.

6. Would your recommendations require changes to the investment policy parameters in SB 1234. If so, what modifications to the statute would you recommended, and why?

PAi: We respect the need for clear program goals. We can see the value of proceeding as written to emphasize the start-up of contributions and account initiation, while simplifying the choices with a capital preservation solution. Our recommendation, however, is to clearly change the charter of the program to allow the market to use all of the skills it has developed to provide choices. It's important that the choices are appropriate to the individuals, designed to meet their communication styles to optimize engagement and create positive outcomes. It is our belief that this program will achieve much more with an engagement-oriented structure that causes people to enroll at higher rates than it will through a carefully crafted capital preservation strategy.

7. What recommendations would you make to ensure an effective risk management system is in place to monitor risk levels of the Program and ensure risks taken are prudent and properly managed?

PAi: There are two levels of risk involved in the operation of a program such as this. The primary risk monitoring string is the participant outcome. By working backwards from the optimal participant outcome all actions, events and occurrences not aligned with that optimal participant outcome can be set off as an alert in a properly operating program. This would include reduced contributions, missed contributions, investment choices not aligned with the participant circumstances as well as "non-events" like the participant not checking their status actively for a predefined period.

The second level of risk that requires a different level of monitoring is the investment risk. There is a completely different set of actions required to properly risk manage the investment risk for the various choices – guaranteed and non-guaranteed – that may be offered through the program. Our expertise is in engaging participants with their outcomes and building a connected network to produce optimal outcomes. We will defer to the investment companies and experts to speak to the appropriate investment risk management attendant to available choices

Plan Design and Features

8. 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?

PAi: The default contribution level cannot be considered on its own. It must be considered in concert with retirement readiness communication and automatic contribution escalation.

Most programs of this nature have suffered by considering the default contribution to be a “system” reality. That leads to policy discussions about raising the default rate – discussions that rarely go well.

The right way to launch the program is to have a default contribution of 3% supported by retirement readiness education/facilitation and include an automatic escalation feature with participant choices. We could also consider a system level metric that if contribution goals were not met, that the systemwide default would increase in steps. After the first wave of participants are enrolled at 3% new participants in year 3 could be enrolled at 5% for example.

9. What options, if any, would you recommend for an automatic escalation feature that increases participants’ contributions over time?

PAi: An automatic contribution escalation feature is critical to the success of this program. The correct way to implement the feature is to provide choices. Examples:

1. Event based triggers – “We see that your pay has increased. We’ve adjusted your contribution to maintain your retirement readiness.” OR “Happy Birthday – you can give yourself the gift of an extra year of retirement by contributing \$64 per pay period – click here to accept. (Next year it will cost \$81 per pay period.”
2. Simple step rate increases – 3%, 4%, 5%, etc...
3. Participant target setting – “I’d like to buy 14 years of retirement readiness starting this year at 3% of pay” “Wonderful – here are 4 payment plans that will get you there!” (These are things that can be accomplished in a mobile engagement, through a call center, etc...)

Choices in payment plans equate to control which in turn equates to confidence and higher contributions.

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? Please explain.

PAi: We strongly recommend that this population of savers be afforded *Gamification* and reward opportunities to make the program more tangible and encourage the right behaviors. The theory of gamification has been around for over 10 years, but has really gained support from big business in recent years. A study by M2 Research claims that gamification can lead to a 100% to 150% increase in engagement. Also, JW Intelligence has found that 51% of American adults agree that if a layer of competition were added to everyday activities, they would be more likely to keep closer watch of their behavior in those areas.

There are a few ideas being worked on that could be significant differentiators for the California Secure Choice Plan, including:

- Getting participants to think about their retirement results differently. Instead of a monetary value, we can focus on how many “years of retirement” the participant has saved. This creates a more clear picture of the journey than a monetary value.
- A “retirement forecast” app that is a type of retirement calculator that has the ability to show participants what their lives look like in retirement and how prepared they are. Most importantly, they would have the ability to take direct action on the app to change their retirement outlook. These actions would include things like: increasing their participation rate, talking to a retirement consultant, etc.

We believe that gamification strategies should be incorporated into the Program to engage participants in their retirement planning and ultimately improve their retirement outcomes.

11. What plan design elements would you recommend to minimize pre-retirement “leakage”?

PAi: In this marketplace, it feels like it would be nice to simply not allow withdrawals and instead create a saving reward system. Premature withdrawals have grown substantially in the last decade and have posed a threat on the overall retirement security of our nation. We realize that by eliminating this luxury it makes it difficult to use the IRA machinery that already exists, but believe it’s critical to the success of the California Program. Our strongest recommendations are a form of counseling. We recommend a proactive solution that utilizes education to help participants understand the impact of their early withdrawal. We suggest putting a call center between the participant and the distribution they are trying to make. This way we have the ability to educate the participant through some of the gamification methods outlined above. The conversation would center around – “You are not just withdrawing \$17,000 in the form of a loan, but instead over the course of your working life this may equate to 2.5 years of projected retirement income.” By putting the dollar amount in real-world terms a participant can understand, such as how many years of their secure retirement they are losing with the withdrawal, will be key to educating them how important it is to not take early distributions on their retirement plans.

Costs and fees

12. Provide a estimate of the ongoing administrative costs and fees of the investment options you recommend and identify the components of those costs and fees.

PAI: We need to be very careful as we consider costs and fees. In the traditional marketplace for a program of this anticipated size, a decision needs to be made as to whether to merely get the recordkeeping done or to spend the money to cause adequate retirement readiness. In other systems of this sort, invariably, rather than spend the money to produce better participant outcomes through engagement, the programs have gone back to the well and raised contribution requirements to promote adequacy. We recommend that the operation of this program be geared, at the outset, to participant engagement through electronic means, backed up by a call center and focused on outcomes. All in costs should be considered when investment options are settled. Costs are greatly affected by participants choices and the presence of guarantees.

13. How would you propose to assess fees to cover the costs required to start up the plan? Please identify the components of those costs and fees.

PAI: We believe that the participating providers should be able to support the program launch as long as clear goals are set.

Attendant costs to setup will include –

Soft dollar costs associated with program design and strategy.

Communication costs – design and execution of public, private, direct and indirect campaigns. Once the program goals and features are clear it would be our expectation that existing materials could be repurposed to the program. Costs of direct mailings combined with electronic mailings must also be considered. Strategic use of free apps and app portals can help cut those costs tremendously.

Support center staffing. Call center staff would need to be ramped up to support system users. The initial wave would be considerably higher than the ongoing support requirements.

We do not anticipate the need for any new software, technology, etc... so we do not see any up front development costs. There will be some simple data exchanges and report writing but no new frontier development.

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?

PAI: PAI operates in a completely fee transparent world today. We believe in educating plan sponsors and participants on the fees that are associated with their retirement plans. Also, we would expect that fee transparency would be a contractual requirement for anyone intending to be a provider in the program. Fee transparency is a value that the program and the providers within will have to embrace to be successful.

The greatest challenge around fee transparency will be associated with costs of guaranteed options. The remaining parts of the program are straightforward.

Administrative issues

15. What are your recommendations for identifying, and disseminating information to, eligible employers and employees (including employees of nonparticipating employers)? Consider the potential roles that could be played by California's Employment Development Department, any other state agencies or departments, and/or private sector vendors.

PAI: We would not anticipate burdening any state agencies with any role other than to provide contact data and status data. To the extent that it does not interrupt current agency functions and deliverables, we can see the benefit of adding awareness materials to existing employer communications, both print and electronic. This opportunity bears careful study as there is a difference in the effectiveness of "compliance" messages versus "education" messages based on venue. We certainly like the cost savings potential of leveraging existing communication devices and pathways, but would be more focused on effectiveness than simply cost.

16. 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, including potential roles for the Employment Development Department, any other state agencies or departments, and/or private sector vendors?

PAI: The retirement and payroll industries have mature processes in place for collecting payroll data and funds. We would highly recommend using those existing systems. Introducing an intermediary agency to that process would likely add costs in the form of more points of failure and data "timing" problems. For example; if a contribution file was submitted to an intermediary agency and it contained an error, the timing of the error identification requires a three stage correction: pre-submission, post-submission and in-flight. Existing industry systems already have those solutions in place. We would recommend leveraging the existing solutions.

A specific recommendation is that the program allows the appointment of "agents". As simple as this program will be for an employer to engage and a participant to individualize, there will still be a large population that is not comfortable with the self service nature of this model. An

employer should be able to appoint someone they choose and trust to operate the program for them. The administration of the program will allow data mining to sort out the success of those agents. This agent process can reduce the cost of operation of the program, leverage private engagement to “get the word out” and implement. It can help with cultural and language barriers. Overall the Program’s design should be inclusive.

17. Do you have any particular concerns about, or anticipate any significant challenges with, administering the Program? If so, how would those concerns and challenges best be addressed?

PAi: If the program can tell a complete participant story, that story can be successfully communicated and operated around the largest benefit to those in the program, as well as those not in the program. The greatest dangers to the administration of the program land solely in the vision of success. If the program has clear goals, then it is a straightforward proposition based on existing solutions. Programs of similar nature suffer when the program lacks a clear roadmap that includes: a simple initial implementation, escalated awareness of adequacy issues, and planning for the resistance that comes with it.

Legal issues

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?

PAi: Workplace IRA’s are already available in the marketplace. If the program sticks to that original format and allows employers and providers to have a conversation about “right sizing” their plan (“If you’d like a higher contribution level with additional administration costs, you can adopt an affordable 401k plan modeled like the Secure Choice program, Mr. Employer”.) – the IRA structure will serve the program goals well. To achieve the goals of adequacy, engagement and outcomes does not require a new plan type, it merely requires an effective administration of the participant journey using existing market solutions. It does not require an exploration of legal options or new plan types.

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

PAi: Structured as noted above, we do not foresee any required changes in any statute. To introduce gamification and rewards in a paired 401k offering (chosen by an employer seeking higher contribution limits, modeled after the Secure Choice Program - but apart from the Secure Choice Program) would require clarity around the “Exclusive Benefit Rule” at the Federal level. We do suggest that clarity be sought around that rule for the good of retirement outcomes system-wide – however it is not an impediment or requirement to roll out the solutions we’ve outlined above.

Establishing Retirement Investments Clearinghouse

SB 1234 grants the Board the authority to establish an online clearinghouse, and to register for inclusion on the website vendors who offer employer-sponsored retirement plans and payroll deduction plans and who meet specified requirements. The cost of establishing the registration process and the online clearinghouse would be borne equally by registered vendors.

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.

PAi: We have direct knowledge that there is an interest on behalf of many providers to support a clearinghouse for a well defined Program.

21. How would you recommend the Board establish 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?

PAi: There are two approaches that we recommend to this part of the program. One is to simply rely on existing regulatory requirements for the ability to manufacture and sell products in this space, combined with transparent and clear information available to the participants and employers perhaps in a benchmarking form. This effort could also include social media rankings with careful thought and consideration. The advantage is that you utilize existing known methods for people to communicate and keep each other engaged. This is new ground but not ground that should be avoided. The other is to use existing market providers of Fiduciary services. There is a market and communication dynamic that will develop, producing some healthy competition as well as education in the social media marketplace.

Developing the RFP for the market research, plan design and feasibility study

22. Do you have any recommendations for the type of firm, or firms that would be most qualified and able to conduct the work necessary for the market research, feasibility and plan design study?

PAi: We believe that there are a number of universities and consulting firms who are capable of completing an excellent analysis. We also believe that there are existing models in the marketplace that will significantly reduce the challenge of quantifying the expected outcomes. We would suggest approaching the challenge from the perspective of the question "Is there anything unique about our situation that will cause us to not have the same experience they are having in other programs of a similar nature?" That's a much more targeted and less costly approach to the analysis than starting with a blank "What if...?" proposition.

It is very important that whatever work is done in this area it is done with an eye toward good old-fashioned consumer marketing and behavioral finance. The correctly designed study will break from traditional financial services and savings models designed to test product viability. California has an opportunity to lead the way with an outcome-based program built on the success of the individual, not the success of the product. It may be a good idea to consider approaching very large consumer oriented companies for assistance with the study as they

have a vested interest in the “smooth consumption curve” that comes with people stepping from their working life into an adequately funded retirement. Companies will not want the burden of operating in states with large unfunded retired populations. It is important that we get outside the retirement industry as we consider this very important program to get the bigger, more deliverable answers that fit peoples’ lives.

23. Are there firms that would be able to successfully conduct all aspects of the work, or is it likely the Board will have to contract with more than one firm?

PAI: Any firm that takes on this study will absolutely need to reach out for assistance in completion of the various areas of the study. There are willing participants in the marketplace. It would seem effective to make one firm accountable for the production of the study with the expectation that elements of the study are referred out to specialists. Given that there are generational differences in the outcomes from the program, we would expect a heavy emphasis on working with people in the millennial generation. This is a retirement accumulation program that will significantly affect that group. Working with current retirees, or those close to retirement who will not have time to develop a core reliance on this program, is important but needs to be kept in perspective.

24. Do you have recommendations about requirements that should be included in the RFP either in terms of the scope of work required or the qualifications of bidders?

PAI: We’ve tried to capture those in the preceding answers. The RFP should do an excellent job of capturing the outcomes and values that we are recommending above.

Strategies for seeking and securing funding for the market research, plan design and feasibility study

By statute, funding to complete the market and feasibility study can only be obtained from the contributions of private individuals, private nonprofit or for-profit entities, from federal sources or from any combination of such sources. The use of State funds or borrowing funds for the study is prohibited.

25. Do you have suggestions and/or examples for the types of organizations that might be able and willing to donate significant funding, or sources of federal funds that might be available for the study?

PAI: We are not aware directly and specifically of Federal funds available for such a study. That said, we don’t think government funding will be required if the study is properly visioned, pragmatic, solutions-oriented in nature, and based on participant outcomes. There is quite a lot of existing work available, so California will not be starting from scratch. If California moves according to the timeline spelled out in the project plan, its first mover advantage means that there will be plenty of firms in the investment and consumer communities who will want to be a part of shaping the solution. There are a number of foundations interested in this area that will be able to assist in securing funding but again, we suggest focusing on consumer impact rather than purely retirement-focused organizations.

26. Given that some organizations do not or cannot donate directly to governments, will the fact that donated funds must be placed in State of California account make it more difficult to raise money? If so, can you suggest funding solutions or arrangements that might help to avoid this difficulty while maintaining the state's independent oversight and jurisdiction over the study?

PAI: We do feel that it will be more difficult to have contributors make contributions to an account owned by a state government. We have two suggestions here: utilize another organization perhaps of a 501c3 nature or a university AND consider making the outcome of the study a "bigger than California" outcome. Plan to involve other states or make the process and product available to them. Right, wrong or indifferent, California is in a leadership position. Taking an inclusive approach will allow other states or entities interested in other states to contribute intellectual and financial capital. This is a great thing that California is doing. That should be leveraged.

Timeline for the market research, plan design and feasibility study

Below is a timeline Secure Choice staff presented to the Board at their first meeting. The Board directed staff to revise the timeline and aim to implement the program and begin enrolling participants in 2015.

27. Do you have recommendations for revising the timeline in a manner that would allow for an earlier implementation date?

PAI: We actually believe the timeline in place here is quite good. A heavy emphasis on leveraging existing solutions will keep the timeline on track but the communication challenge should be given proper attention. When the form of the program is decided a very clear bright line should be drawn on announcing the program so that it minimizes the issues around "What the program is" and "What it is not."