

*Response for:*

**California Secure Choice  
Request for Information**

November 15, 2013



## Corporate Overview

PenServ, Inc. was formed in 1986 and has been working with defined contribution plans for 27 years. In 1997, the firm expanded its menu of services, by adding third party administration and daily valuation services for unbundled plans through a joint venture agreement with the METASA Group, Inc. The two firms operated under this arrangement until 2009 when the newly formed PenServ Plan Services, Inc. began offering a plan administration program that included voice response, participant Internet access, electronic trading, and participant communication / enrollment services. PenServ currently administers more than 1,200 defined contribution plans in 36 states.

PenServ is a privately held women-owned corporation organized under the laws of South Carolina. From its two locations in Pennsylvania and South Carolina, the firm delivers an extensive array of technical products and services to the retirement plan field including: consulting, prototype plan documents, and training programs for investment professionals, employers, and practitioners. The open-architecture mutual fund platform offers more than 8,000 fund options, allowing investment partners a wide range of alternatives for plan sponsors. In addition, PenServ handles client inquiries, publishes periodic newsletters, and assists plan sponsors with compliance reviews and complex IRS correctional procedures.

Members of the PenServ staff are considered experts in the 403(b)/457(b) area and are frequent speakers at industry conferences, ASPPA education events and NTSAA meetings. Susan Diehl, Senior Consultant, is a member of the Tax Exempt and Government Plans Advisory Council that works with IRS in the development of guidance and regulations for the retirement plans industry. She is certified to practice as an Employee Retirement Plan Agent.

## Contact for RFI

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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., a pooled fund with guaranteed interest credited to individual accounts on a regular basis that utilizes a gain and loss reserve? Individually held IRA-type accounts with a variety of funds from which participants could choose? Something else altogether?)

In order to meet the objectives of SB 1234, the best choice of retirement product would be an Automatic Enrollment IRA, similar to what is being proposed under HR 2035 as introduced by Rep Neal, “the Automatic IRA Act of 2013”.

This can be set up either under a:

- model IRA document (Form 5305) that is customized to reflect any specific requirements that may be desired by California Secure Choice;
- Prototype IRA that is customized and submitted to the IRS for approval; or
- A custom “Employer IRA” that is drafted, submitted to the IRS for approval. This choice may include the design of preventing “leakage” from the IRA but requiring for example that no distributions may be made until a future age (i.e. age 59 ½).

Currently (and going back to the first Automatic IRA proposal in 2009), the best thing about all of these proposals is that the automatic IRA would *not be subject to ERISA (the Employee Retirement Income Security Act of 1974)*. The compliance costs and potential liability associated with ERISA are the main reasons many small employers don't want to be involved with retirement plans. So removing that barrier is huge, and a major step toward increasing retirement savings. This may require a determination letter from the IRS after drafting is complete to make that determination.

An Employer IRA, if adopted by a nongovernmental is subject to ERISA under current law, but this issue can be addressed with the Department of Labor if desired.

## 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)?

**PenServ is not an investment company, however we work with many firms that share the investment liabilities (3(21) investment firms) with employers and will manage, review and provide the investment disclosure information for IRA accountholders. With the release of the GAO report on rollovers, this has become a major concern for IRA investment providers. The balance of the section is not addressed by PenServ.**

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?
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?
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?
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?
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?

## Plan Design & 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?

**The most common default rate for automatic enrollment is 3%. However there are many professionals/economists who believe this should be higher to achieve sufficient retirement income.**

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

**Consideration should also be given to automatic escalation annually and then capped at a certain percentage. For example the IRA could be written to permit 3% as the default for auto enrollment with an increase annually of 1% and capped at 10%.**

**The employee will always have the option to voluntarily increase or decrease their deferral rate.**

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.

**The Automatic IRA should include 2 different custodial agreements for choice by the employee. Default should be to a Traditional IRA with a choice by the employee to contribute to a Roth IRA instead. This permits the employee to have the initial automatic amounts contributed to a Traditional IRA where regardless of compensation and marital status can contribute, although it may be nondeductible. Whereas if the original default went into a Roth IRA, it may be an “excess” if the employee earns over a certain dollar amount based on their marital status.**

**See above for discussion involving an Employer IRA. The Employer IRA should be written and approved as a “dual IRA”, permitting the document to encompass both the traditional and Roth features.**

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

All of the items mentioned above as well educational materials such as the “Saver’s Credit” disclosure to show the value of a tax deduction as well as a tax credit. IRS provided Saver’s Credit explanation is great and shows the employee how by contributing to an IRA, in addition to receiving (potentially) a deduction, a tax credit on top of that can reduce income subject to income taxes substantially.

Information relating to IRAs should also be developed for answers to frequently asked questions.

The other provision that would prevent leakage as mentioned above is to design an “Employer IRA” which may have limited distribution options which are different than a normal IRA that is selected from a financial organization. Limited distribution options can be included at the discretion of the Employment Development Department. Distributions may be limited to prevent, for example distributions to be made before a certain age, whereas the typical IRA has language to prevent distribution at any time.

## Cost & Fees

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

Traditional and Roth IRAs handled currently by trustees and custodians have an annual maintenance fee of anywhere from \$10/account to \$50/account depending on the investment company offering the IRA. This fee is to be used for the mailing of requirement tax reporting and other required statements. The fees are typically assessed annually on a given date during the year. Therefore in the new program maintaining an annual fee coming from the participants assets would not be a new feature and could be used for offsetting the maintenance, recordkeeping, and tax reporting that is required on these types of accounts.

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.

Administration/maintenance fees would be assessed as stated above annually; quarterly or monthly. In order to provide for the start-up costs, the initial first year fee would be charged at the set-up of the IRA after the first contribution is made into the account.

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?

Fee disclosure can be made available for the participants on the website/intranet of their employer similar to the required fee disclosure that is used for ERISA plans. Many providers are already set up to provide fee disclosure on nonERISA government 403(b) plans. This would be an extension of that service. Also remember that IRAs have always had a requirement to provide a Fee Disclosure as a part of the IRA disclosure document.

## 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.

The vendor selected that will prepare the government reporting and recordkeeping of the assets should periodically (to be determined by the Board) prepare files that can be downloaded to the employer's website for view by the participants. This should include the fair market value; to-date contribution information and the year to which the contribution relates; identify rollovers being contributed as well as any other type of contribution being made.

Educational Information should be made available on the employer's website; the Employment Development Department; and at the vendor level, if appropriate.

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?

Since there is a possibility to be handling small, medium and larger employers, careful drafting of an enrollment guide that can be uploaded to the employer's website for employers, or printed for providing paper copies will be needed. Assistance for the employers would also be needed to train on how to use the website (presumably this will be the California Employment Development Department's site; but can also be housed on an approved vendor's website); provide on-going assistance (phone, email, live chats, etc.) for questions; assistance with common remitter services if requested by the Employer.

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?

No concerns, as long as a competent IRA consultant or provider are selected to assist The Employment Development Department in constructing the design and recordkeeping functions. Also such firm should be well versed in the design of IRA documents; required administrative forms; and reporting and withholding requirements. It is with respect to the documents and the reporting that much of the IRS penalties are surrounded.

## 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?

Currently (and going back to the first Automatic IRA proposal in 2009), the best thing about all of these proposals is that the automatic IRA would *not be subject to ERISA (the Employee Retirement Income Security Act)*. The compliance costs and potential liability associated with ERISA are the main reasons many small employers don't want to be involved with retirement plans. So removing that barrier is huge, and a major step toward increasing retirement savings. This may require a determination letter from the IRS after drafting is complete to make that determination.

Under the Neal Bill, Employers will have no ERISA fiduciary liability for worker investment decisions.

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

If the Employment Development Department will include the provision of an “Employer IRA”, legislation should be drafted (with possible input from the Department of Labor) to assure that these accounts will not be subject to ERISA if a nongovernmental employer adopts such a plan, focusing on the automatic feature which we know would not in and of itself make this subject to ERISA.

# Establishing a 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.

If the Automatic IRA program will offer investments directly through a choice of multiple vendors, then there should be an online clearinghouse. The fee for registration through the State should then be an annual fee to be paid by the vendor. Since this is an IRA investment product it is unclear whether there would be enough interest to establish the online clearing house. Many IRA providers already use independent vendors to assist in tax reporting and recordkeeping. This may warrant an outside independent third party administrator that is familiar with IRAs to handle the tax reporting and recordkeeping on behalf of the California Employment Development Department.

Also consideration should be given to the number of IRA holders (participants and beneficiaries) that will call for information and questions on their IRAs. Unlike qualified plans and other employer plans

If the Board, instead, decides to go through a “platform” of investments, then there will be only one “vendor” through a Trust company with the investment choice being part of the platform.

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?

The Board in operating this clearinghouse could use the services of a 3(21) firm that will take on a portion of the liability for losses on investments. There are also firms (referred to a 3(38) firm that will assume all liabilities for the losses in investments. Consideration should be given to both such firms in drafting the RFP for vendors.

## 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?

**Due to the complexity of designing an IRA package(s) that will meet both the needs of the Department and Employers and provide the attractiveness to the Employer, we believe that the Department may need two firms – one that is familiar with the technical provisions of IRAs and one that is familiar with investments.**

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?

**We believe that this will need to include two firms, unless a technical firm is contracted with and such firm reaches out to an investment consultant as a part of the agreed upon contract.**

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?

**Once again due to the nature of this RFI, it is essential that one of the firms be a technical consulting firm that is familiar with IRAs. Investment companies typically outsource the technical functions to another outside independent firm and therefore will not have the expertise in-house.**

## 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. **No comments by PenServ in this section.**

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?
  
26. Given that some organizations do not or cannot donate directly to governments, will the fact that donated funds must be placed in a 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?

## 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?

**No, we believe that the timeline is appropriate, well-defined and doable.**

<b>Activities</b>	<b>Dates</b>
Release the RFI and receive responses from experts and scholars	Sept. 2013 – Nov. 2013
Prepare RFP for the market and feasibility study	Sept. 2013 – Jan. 2014
Release RFP and choose vendor(s) to conduct the study	Jan. 2014 – April 2014
Vendor(s) conduct market and feasibility study	April 2014 – Oct. 2014
Board considers study recommendations and transmits final report with recommendations to the Legislature, including a request for the authority to make the Program operational if the study's findings are favorable	Oct. 2014 – Jan. 2015
If the Board recommends making the Program operational, and in anticipation of receiving Legislative authority to do so, develop RFPs for administrator, record keeper, investment consultant and other contracts necessary to operate the program.	Jan. 2015 – July 2015
Enactment (or failure) of an authorizing statute expressing the approval of the Legislature to fully implement the Program	July 2015
If authorizing statute is enacted, begin the bidding process for vendors and consultants necessary to administer the Program	July 2015 – Oct. 2015
Secure Choice begins enrolling participants	Early 2016