November 15, 2013

To: Grant Boyken
From: Karen Friedman and Norman Stein, Pension Rights Center
Re: RFI #13-01 California Secure Choice Retirement Savings Program

Founded in 1976, the Pension Rights Center (PRC) is a nonprofit consumer organization that works to promote and protect the retirement income security of workers, retirees and their families. For 37 years, our mission has been to ensure that all workers have sufficient money to live on when they retire. We work to accomplish this goal by developing forward-looking retirement policies and by serving as a voice for consumers on retirement income issues with policymakers and the media. We also provide legal and technical assistance to pension counseling projects that provide hands-on assistance to people with pension and 401(k) problems in 30 states.

These comments are submitted by Karen Friedman, executive vice president and policy director of PRC, and Norman Stein, a law professor at Drexel University, who is also PRC's senior policy advisor.

Both Karen and Norman are willing to participate in follow-up interviews.

Contact information:
Karen Friedman
Pension Rights Center
1350 Connecticut Avenue, NW, #206
Washington, D.C. 20036
202-296-3776 (work)
Kfriedman@pensionrights.org

Norman Stein
Earle Mack School of Law at Drexel University
3320 Market Street
Philadelphia, PA 19104
205-410-0989 (cell)
nps32@drexel.edu

General comments

The Pension Rights Center strongly supports the establishment of the California Secure Choice Savings Trust to provide an easy, efficient, and cost-effective system of automatic payroll-deduction IRAs to help millions of Californians save for retirement. Behavioral research has demonstrated that opt-out systems such as that proposed by the California law can be successful in increasing retirement savings. As noted in the comments of both the Economic Policy Institute and the New School for Social Research, pooling assets through the Secure Choice Trust will reduce risk for participants and keep fees low by taking advantage of economies of scale. Also, the Secure Choice Trust, which could be managed by the state retirement system or by one or more financial institutions, could provide a principal guarantee and a guaranteed rate of return determined at the start of each plan year. The system established by the legislation could contract with private insurers to ensure that these guarantees are met. PRC believes that protecting at least the principal in these accounts for older employees is important to ensuring long-term retirement security for participants.

Studies show that private-sector vendors of investment products have not typically offered investment products with the combined features contemplated by the Secure Choice Trust program: low fees, pooled and professional investments, guarantees, and lifetime income. We thus think that the Secure Choice Trust is an ideal vehicle for employees whose employers do not otherwise offer a workplace retirement plan, and we believe implementation of the program will meaningfully expand the number of Californians who save adequately for retirement. Moreover, we believe that the Secure Choice Trust will be an important laboratory for demonstrating how states can help their citizens prepare for retirement. California has an opportunity to lead the nation.

We respond below to some of the specific queries in the RFI, but our responses are directed primarily to five concerns: (1) plan structure; (2) the need for annuitization; (3) plan design and features; (4) legal issues; and (5) consumer monitoring of the retirement clearinghouse

1. Plan Structure

Experience with self-directed defined contribution plans has taught us that participants often lack the ability, time, and experience to optimally shape retirement portfolios when given a choice of competing investment options. Moreover, when participants are offered a choice of investment options, fees trend higher, not only because a single, pooled investment fund provides significant economies of scale but also, as the New School points out, because mutual-fund type options will typically require the plan to pay an unnecessary liquidity premium.

While some may argue that permitting investment choice will keep employees who wish to shape their own investment portfolios in the Secure Choice program, we believe that the costs to the program, in terms of increased fees and suboptimal portfolio allocation of some employees when presented with a multiple-investment option, far outweigh whatever modest gains in participation might be accomplished by offering employees investment choice.

We also note that a plan that offers employees a choice of investment options will necessarily resemble a typical 401(k) plan and will thus create a risk that the plan would be characterized by regulators as an ERISA plan. Also, offering investment options might increase a plan's operating expenses, since the Secure Choice program would need to engage in additional educational efforts to help employees make choices, which will entail increased costs – costs that would be borne not only by employees choosing alternative investment options but by all employees. Finally, offering employees a choice of investment options could lead to additional administrative burdens, for example, in following employee investment instructions.

We also favor SB 1234's approach of providing annually an announced interest rate, perhaps with the possibility of dividends similar to that provided by TIAA, and development of asset reserves. As we noted, especially for employees approaching retirement, a guarantee against loss is important. We would also recommend the exploration of the use of notional accounts and providing older employees with increased assurance against loss of account value in the event of catastrophic collapse of investment markets.

The Secure Choice program structure should also include participant-protection features. For example, there will inevitably be some employers who fail to remit in timely fashion the amounts withheld from their employees' compensation. There needs to be a mechanism to identify and remedy such failures. There will also inevitably be participants who believe that their reported account balance is incorrect, and there should be a mechanism in which employees can query and appeal the amount credited to their account balance.

To address these issues and other issues that concern participants, the Pension Rights Center recommends that the Secure Choice board of trustees explore creating a position that would represent participant interests, act as an ombudsman, study problems as they arise, and make recommendations about improving the operation of the fund annually and as necessary. This position/office should be separately staffed and should be independent of other parts of the program so that it can perform its functions effectively.

2. Investment Options and Annuitization

As noted before, we believe that the assets of the Secure Choice Trust should be invested in a single, pooled, professionally managed fund. The investment portfolio should be chosen by dedicated investment managers from CALPERS or a contracted firm.

We believe it is essential for Secure Choice to provide for lifetime income and that consideration should be given to having some of the fund's assets invested in low-cost annuity contracts issued by highly rated insurers. The fund would have a strong bargaining position to negotiate the purchase of annuity contracts on favorable terms. In order to ameliorate interest rate risk at the time of retirement, consideration should be given either to gradually shifting assets in the accounts of older employees to annuity contracts on a periodic basis after the employee reaches a certain age or to developing an alternative mechanism to smooth interest rates. Study should also be given to the merits and drawbacks of purchasing annuity contracts to pool mortality risk versus other options for pooling such risk.

We also recommend that the board study the desirability of mandating annuitization or partial annuitization for people at retirement to ensure that they do not run out of money during their lifetime.

3. Plan Design and Features.

We would consider eliminating leakage prior to retirement in all cases, except with respect to benefits payable at death or disability. An administrative procedure to limit withdrawals to certain events or hardship, or to make loans, would be expensive to maintain and might be perceived by participants as unfair or arbitrary in its results. (Also, loans from IRAs would violate rules in the Internal Revenue Code.) If some pre-retirement access to savings is deemed necessary, we would urge the board to consider limiting it to a percentage of employee contributions.

4. Legal Issues

Secure Choice must have assurance on three legal issues: (1) that Secure Choice will not be an employer plan under ERISA; (2) that the Secure Choice legislation and regulation will not be preempted by ERISA; and (3) that the Secure Choice Trust will be treated as an individual retirement account under the Internal Revenue Code.

The Pension Rights Center has researched these issues and has concluded that the Secure Choice program should be able to receive positive guidance on these three issues. We will be preparing a white paper on the issues, which we think will be helpful in addressing the issues and securing regulatory guidance. We will discuss briefly each of the issues:

- The Secure Choice program is not a plan subject to ERISA.

ERISA provides that an employee pension benefit plan is a plan, fund, or program established or maintained by an employer or by an employee organization, or both, that either provides retirement income to employees or results in a deferral of income for periods extending to the termination of covered employment or beyond. While the Secure Choice program is, of course, expressly designed to provide retirement income to its participants, it is not a plan established or maintained by an employer or employee organization. It is a state program for employees whose employers do not provide a retirement savings program. The program allows the employee to make voluntary contributions to the Secure Choice Trust through payroll deduction, thereby making it simpler for employees to save.

An employer required by California law to remit an employee's retirement contribution through payroll deduction to the California plan is not choosing an investment vehicle, nor determining the default rate of contribution, nor designing or endorsing any feature of the plan; the employer is merely facilitating its employees' right to save for retirement under state law. Moreover, the members of the Secure Trust Board have fiduciary responsibility under the law to run and manage the Savings Trust for participating citizens. It is a program to help citizens of California avoid poverty in retirement, and the use of a mandatory payroll deduction only helps to accomplish this goal.

Moreover, a Department of Labor (DOL) Field Assistance Bulletin (2006-2) appears to support this view. In its bulletin, the DOL took the position that employer contributions to a health savings plan do not result in the creation of an ERISA plan, if, for example, the employee can withdraw the funds. The Field Assistance Bulletin, hence, supports the view that a voluntarily adopted payroll deduction IRA program with a participation default would not be an employer plan.

- ERISA would not preempt the Secure Choice legislation.

ERISA preempts state law that relates to employee retirement or welfare benefit plans. In a case with parallel facts, the Ninth Circuit Court of Appeals held that a San Francisco ordinance that required employers to spend a specified dollar amount per employee on health care, either through an employee plan or otherwise, was not preempted by ERISA. *Golden Gate Rest. Ass'n v. City* &. *County of San Francisco*, 512 F.3d 1112 (9th Cir. 2008). The Court held that the required payments were akin to wages and did not require an employer to modify or adopt an

ERISA plan. The Ninth Circuit voted not to rehear the case en banc and the Supreme Court denied certiorari.

The argument against preemption of the Secure Choice law is even more compelling than the situation considered in *Golden Gate*. Unlike *Golden Gate,* the employer under the California system would not make an employer contribution but would only be required to remit employee voluntary contributions to a retirement savings fund maintained by California.

- The Secure Choice Trust can meet all IRA requirements.

Although we will explore this in more detail in our white paper, we do not believe there is any plausible reason why the Secure Choice Trust cannot be structured to satisfy all applicable legal requirements for individual retirement accounts under the Internal Revenue Code, whether it uses notional accounts or uses third-party guarantees for a participant's proportionate interest in a pooled fund.

5) Retirement Investments Clearinghouse: need for consumer monitoring

SB 1234 grants the board the authority to establish an online clearinghouse to publicize other Auto IRA plans and services. Earlier, we mentioned the need for an ombuds position to address consumer concerns. We believe such an office should also help monitor the accuracy and clarity of information displayed on the Retirement Investments Clearinghouse website, particularly with respect to fee disclosures, the provision of education or investment advice, and the identification of actual and potential conflicts of interest.