MARCH 28, 2016

AGENDA ITEM 06
INFORMATION ITEM

CALIFORNIA SECURE CHOICE RETIREMENT SAVINGS INVESTMENT BOARD

Review and Adoption of Recommendations to Legislature

This item will be presented verbally at the meeting.

Attachments

- Attachment #1: Overview of findings from the market analysis, program design, and financial feasibility study of the California Secure Choice Retirement Savings Program
- Attachment #2: Legal Analysis of Overture Financial Final Report
- Attachment #3: Draft letter from California Secure Choice Retirement Savings Investment Board regarding recommendations for legislation implementing the California Secure Choice Retirement Savings Program
- Attachment #4: Comment letters regarding findings from the market analysis, program design, and financial feasibility study of the California Secure Choice Retirement Savings Program

Final Report Overview

by

Overture Financial

to the

California Secure Choice Retirement Savings Investment Board

Market Analysis

Profile of Eligible Workers

- About 6.8 million workers are potentially eligible for the California Secure Choice Retirement Savings Program representing 55% of private sector workers age 18-64 who do not have access to a workplace retirement plan.
- 59% are under the age of 40; One out of three are 18-29 years old.
- 66% are workers of color; 46% are Latino.
- 55% of eligible workers are male; 45% are female.

Job-Related Characteristics

- The median wage is $23,000

- 54% work in firms with less than 100 workers; 43% work in firms with less than 50 employees.

- 83% of workers are full-time; 17% are part-time.

- Nearly half of the eligible workforce is in retail, accommodation and food service, healthcare and social services, and manufacturing.

Survey and Focus Group Results

- Most uncovered workers in California, even those who are low-income, want to save for retirement and feel that they could save at least a small amount.

- Workers value payroll deduction as an easy way to save.

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

- Likely participation rates (70-90%) are sufficiently high to enable the program to achieve financial viability.

Feasibility Study Findings

- The Secure Choice Program is financially viable and self-sustaining, the reports claims this even under adverse conditions with poor investment returns and high opt-outs rates.

- Total fees to participants need not exceed 1% of invested assets and such fees can decline to significantly lower levels after the first 6 years of operation.

Program Design Relating to Employees

Definition of Employee

- All employees who receive W-2 and whose pay is subject to CA Unemployment Insurance taxes.
- No exemption for part-time, short-term and seasonal employees
- Recommended minimum age: 18

Employee Program Design

- Automatic enrollment, employee has 30-days to choose to opt-out.
- 5% default contribution rate.
- Auto-Escalation to be implemented in 1% increments up to 10%, after the program has sufficiently phased in, and only if the process can be coordinated by the recordkeeper.
- Limit pre-retirement withdrawals to hardship situations.

Investments

Overture has outlined two different investment models for Board consideration.

1) Dynamic Asset Allocation Managed Account Investment Strategy. Individual IRA accounts owned by participants but managed by the Secure Choice selected investment firm, pending legal confirmation that managed accounts are permissible. Use Target Date Funds as fallback.

- Secure Choice Board should create proprietary investment vehicles to be offered to participants.

- For the first three years the investment would be very low risk, followed by a target date investment strategy based on the participants age. Participants could choose a low-risk, moderate, or aggressive investment strategy.

Investments

2) Pooled IRA with Reserve Fund packaged as a Retirement Savings Bond.

- All contributions would be pooled and each participant would be issued a bond equivalent to the value of their contribution.

- Returns on the fund up to 10% would be passed on to participants. Excess would go to a reserve to be used, when sufficient funds available, to smooth negative returns.

Employer Program Design

- Mandate would apply to employers whose average employee headcount reported on EDD Form DE-9 for the 3rd quarter (ending 9/30) is 5 employees or higher. Only California resident employees included in count.

- Eligible firms that downsize to less than 5 employees would continue auto-enrollment/payroll deduction through remainder of calendar year. The following year, employer may choose to keep contributing for EEs already enrolled but may not auto-enroll per draft Department of Labor proposed guidelines.

- Exempt from requirement if at least one employee is eligible for the employer's qualified employer-sponsored plan.

- Per DOL proposed guidance, mandated employers would be exempt from ERISA. Employers would have no fiduciary responsibility for the program or liability for employee participation.

Operational Model

Direct Service Operational Model.

- EDD provides employers instructions on contacting recordkeeper. Employer sets up automatic payroll contributions with recordkeeper.
- Recordkeeper would have sole responsibility to verify accountholder identity; notify employees of opt-out process.
- Recordkeeper would have direct relationship with employees and is contact for all issues related to individual account: contribution elections; ID/SSN issues; refunds.
- Employer out-of-pocket outlays are not likely to be very significant.

MEMO

By Email

TO: California Secure Choice Retirement Savings Investment Board

FROM: David E. Morse

DATE: March 17, 2016

RE: Overture's Final Report dated February 9, 2016

I have reviewed Overture's Final Report dated February 9, 2016. The Report lists several outstanding legal questions, which cannot be definitively answered at this point, but which should not prevent the Board from recommending that the Legislature proceed.

The Report recommends several Secure Choice Program options--such as limiting pre-retirement withdrawals, which are not allowed under the proposed ERISA safe harbor. The Board provided comments to the Department of Labor on these and other aspects of the proposed regulations, arguing for a less restrictive approach. When issued, the final regulations must be carefully reviewed to determine both whether any changes to the Program are required and whether any desired features can be added.

The precise the methodologies for complying with Patriot Act identification requirements should be addressed with potential recordkeepers during the RFP process. Generally, these requirements will be satisfied if the employer provides the recordkeeper with "good" information about itself (e.g., EIN, bank account and address) and on its eligible employees (e.g., name, address, DOB and SSN). Any problem, such as mismatches between name and SSN or invalid SSN, must be addressed by the affected person providing additional documentation to the recordkeeper.

The Report proposes two alternative investment approaches: (1) an asset allocation strategy using life cycle/target date funds; and (2) a "reserve fund" structured as a bond issued by a newly created California public authority in which IRA assets would be invested. As you know, we have recommended that the Board request the staff of the Securities and Exchange Commission ("SEC") to issue a "no-action" letter or other appropriate confirmation that the Program, particularly the "Secure Choice Trust" (the vehicle used to hold Program investments), is an instrumentality of the State of

California and therefore not subject to the federal securities laws. Without such confirmation, it is possible that Program would be considered an “investment company” under the Investment Company Act, and other aspects of the Program could be regulated under the federal securities laws. This would require registration with the SEC and significant reporting and disclosure obligations, which could make the Program considerably more expensive to operate. Thus, once the Board selects an investment structure and gives K&L Gates the go-ahead, we will begin the process by approaching the SEC staff. We hope that the Board will be joined by the Illinois and Oregon Boards in these efforts.

The Board should be aware that, while we believe a favorable outcome should be achievable, each of the alternative investment approaches may present some novel issues for the SEC staff.

Secure Choice Trust investments in target date/life cycle funds could present issues for the SEC staff, depending on the Board’s preference for SEC-registered (off-the-shelf) or unregistered (custom or white label) investment vehicles (or both). Investments in SEC-registered target date/life cycle mutual funds generally should not present additional issues. Unregistered target date/life cycle funds such as collective investment funds maintained by banks or insurance company separate accounts, on the other hand, generally are available as investments only for tax-qualified 401(k) and other retirement plans but not IRAs. Thus, if the Board wishes to have the Secure Choice Trust invest in unregistered bank or insurance company funds, the SEC staff will need to consider (and be persuaded that) the Secure Choice Trust should be considered an eligible participant in such vehicles.

Regarding the reserve fund, we expect that it may take the staff significant additional time to understand and get comfortable with the reserve fund concept (as compared to investments in more familiar target date/life cycle funds). Because Illinois and Oregon are expected to offer only target date/life cycle funds, any added legal costs associated with the reserve would be borne entirely by California. Also, the reserve fund will require legal work in establishing the public authority and preparing the appropriate documents.

The reserve fund approach also requires several unique inter-cohort balancing issues to be addressed by the Board or in the enabling legislation. For example, some early participants and short term participants may not benefit from the reserve and could even experience reduced returns in good market years when “excess” returns are funneled to the reserve fund. Others, who participate during bad years, may benefit from the reserve accumulated by previous investors. In addition, if the reserve fund becomes sizable, the Board and the State Government may face pressure to “break open” the reserve for immediate allocation or, conceivably, some State purpose outside the Secure Choice Program. If the Board recommends the reserve fund, it should consider whether it wishes to limit the flexibility of the future board which will be responsible for the Program by asking the Legislature to hard-wire the reserve fund's operating rules for accumulating and applying the reserve in the Secure Choice enabling legislation. The reserve fund is not legally superior or inferior to the target date/life cycle approach; nevertheless, the Board should be aware of these issues in making its decision.

Finally, it is likely that various legal and administrative issues will remain open even after the Board makes its final recommendations. Thus, it is critical to the success of the California Secure Choice Program that the Board's recommendations and the eventual enabling legislation build in significant flexibility to adjust and readjust the Program as circumstances change.

Please let me know if you have any questions or would like to discuss further.

cc: Grant Boyken
Christina Elliott
William Wade

CALIFORNIA SECURE CHOICE RETIREMENT SAVINGS INVESTMENT BOARD

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March 28, 2016

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

To Whom It May Concern:

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 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

The findings of the market analysis as well as the corresponding legal analysis are attached to this memo. Based on the findings of the final report, stakeholder feedback, and public comment, the Board recommends that Senate Bill 1234 allow the Board to:

- Establish managed accounts that would be invested in U.S. Treasuries for the first three years of the program

    - Recognizing there are legal and practical hurdles to overcome before the various investment options could be implemented. After three years, the Board should begin to develop investment options that address risk-sharing and smoothing of market losses and gains. 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-private workers to be enrolled if found legally permissible

- Develop an intensive communication and education campaign for both employers and employees both at launch and continually that includes information about the inherent risk in investments

- 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

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.

Legislative language consistent with these principles will provide the Board with sufficient flexibility to shape the program as it develops and react to changes in the market, while protecting workers' contributions and limiting employer burdens. Your support is paramount to the Board's ability to lay the groundwork for the Program.

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. We also acknowledge the need to further evaluate costs with respect to customer service needs and record keeping. California continues to be a thought leader on this front and believes that every worker deserves the option to retire with dignity. I 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

CC: Chair of the Senate Committee on Labor and Industrial Relations
Chair of the Assembly Committee on Labor and Employment
Chair of the Senate Committee on Public Employment and Retirement
Chair of the Assembly Committee on Public Employees, Retirement and Social Security

March 10, 2016

The Honorable John Chiang
California State Treasurer
Chairman, California Secure Choice Investment Board
915 Capitol Mall, Room 110
Sacramento, CA 95814

California Secure Choice Market Analysis, Feasibility, and Program Design Final Report

Dear Treasurer Chiang,

The Association of California Life and Health Insurance Companies (ACLHIC), representing many of the largest life and health insurers doing business in California, and the American Council of Life Insurers (ACLI) representing over 300 life insurers nationwide, are pleased to submit this comment letter regarding the recently released consultant's report referenced above.

There is a retirement crisis facing not only California, but our nation.

The life insurance industry provides a wide range of retirement products to all market segments. Saving and providing financial products for an aging population is our core business interest. Our industry seeks to be an active and positive contributor to public policy initiatives that address these crises.

By 2017, the United States is forecast to contain more people over the age of 65 than those under 5 years of age. Combined with an unsteady future for the sole retirement lifeline currently available to those who are unprepared for the financial needs of their retirement years, the looming crisis will continue to be compounded by current economic and demographic trends.

These trends are not encouraging. Low personal savings rates, lack of retirement planning, poor debt and credit management, and general absence of financial literacy outreach regarding these critical life choices have unfortunately not dominated efforts to address these shortcomings. As a result, we find ourselves in a position as a state and nation of having large portions of our populations facing the prospect of outliving retirement assets.

Emphasizing the need to save and plan is as important as providing a pathway to saving for retirement. There is an element of personal accountability that can only be determined by the individual and their individual needs. Most of us today only begin to think about these detailed preferences closer to the actual date of retirement, at which point we have a better sense of our health status, dependent responsibilities, ability and willingness to continue working beyond the traditional retirement age, whether other sources of income are available such as a working spouse, and where and how we would like to live. Only when combined with a clear-minded analysis of our outstanding obligations and liabilities, traditionally in the form of debt, can we really ask ourselves "am I ready?"

Current statistics detailing the national average response to that question are an overwhelming "NO".

Most people would likely be shocked to learn that if you retire at 65 with a $500,000 account balance and you withdraw 5 percent (or $25,000) per year adjusted for inflation, there is a significant risk that you could run out of money before you die.

This example only highlights the fact that having enough knowledge, and not just enough money is a crucial component of any effort to redress the current situation.

It is through this lens that we comment on the "Market Analysis, Feasibility, and Program Design" report prepared by Overture Financial LLC. We wish to emphasize that we do not want these comments to be taken as antagonistic. Rather, we hope that further thought and analysis will lead to a better result. A program that fails to meet built up expectations or damages existing private plans would be a step backwards rather than a collective leap forward.

Our member companies are fully committed to solving the retirement challenges of an aging population. We have the expertise, qualifications, and experience to provide sustainable plans and products for today's employers and insurance consumers and are pleased to share our perspective with you. Our industry is well regulated, with strong solvency and consumer protection requirements that ensure products are sustainable and built to last.

We commend the SCIB for its efforts over the past year to absorb, analyze and process the segmented information presented during board meetings and now contained within the final report. It is a huge step in the right direction for Senator de Leon and the Secure Choice Investment Board to have identified, studied, and encapsulated the problem of retirement un-readiness in California.

However, we feel very strongly that parts of the report would benefit from further analysis and modelling for plan participation. Many areas need more focused detail, especially the public education and financial literacy components. The central plan element, auto-enrollment, will require a high level of service and communications that is not fully addressed in the report. For instance, participants will need to understand that participation alone is not a guarantee of secure retirement, and that the level at which they were enrolled, even with auto-escalation, may not be enough to satisfy their individual retirement needs when the time comes.

We understand the difficulty of fashioning a uniform solution for so many individuals. Especially because those individual needs will require their active and engaged participation. The habit of saving must become second nature, like that of brushing ones' teeth. The messaging of personal accountability in planning for retirement must be as widespread as successful public policy advocacy campaigns such as "Click it or Ticket" and "Keep America Beautiful". Both transformed the habits of everyday Americans, and a similar transformation is needed to encourage Californians to prepare and save for retirement.

As stakeholders throughout the development phases of the report, we submit the following comments and questions for consideration by the board. We do note with some disappointment that our organizations which have deep experience in financial, investment, and retirement plan issues, were not contacted by the researchers during the process.

Page 7: The "Program launch should include a concerted public education campaign focused on workers and small businesses".

- Who pays for the outreach? Is it scaled and phased-in similar to the roll-out of the Affordable Care Act? Industry experience today shows a significant outlay of resources for marketing, education, and advertising, yet we still have low participation rates overall. The report does not specify expenditures for this component, thereby introducing doubt as to the validity of projected program costs. The need for outreach and public education is unquestionable, and in our view, should be conducted on such as scale as to reach beyond the target audience alone. Public advocacy for retirement planning, preparation, and readiness, combined with basic financial literacy must be included as the foundation for long lasting success. The virtues of auto-enrollment and behavior shifting are negated if we do not simultaneously and consistently empower prospective enrollees with the knowledge and tools to make those savings grow and last.

Page 10: The report calls for a "5% default contribution" but also states that "employees can elect [the] percentage or fixed $ per paycheck with no minimum".

- The modelling performed later in the Overture analysis envisions scenarios where employees contribute the default % (or more), but with no mandatory minimum. However, what does the modelling look like if a significant number of participants only contribute 1% or less? Should the program be scored at a range of default rates? 5% (or more), while certainly recommended as the most beneficial default amount, may not be affordable.

Page 12: The report points to "no exemptions for part-time, short-term, and seasonal employees".

- Would this apply to independent contractors, for whom payroll taxes and other deductions are not taken out as they would be with a W-2 employee, but only reported as a lump sum payment on a 1099?
- The report does not consider what must certainly be a significant portion of the target population: employees with multiple jobs. Would the employee be auto-enrolled by each employer? If not, who determines the "lead" employer and what responsibilities or liabilities are incurred by the others?

Page 12, 13, 14: The report references "Strong record-keeper controls to prevent miss-steps in enrollment", in addition to "record-keeper flags when contributions approach standard limits and issues refund" and "record-keeper electronic validation of identify of new enrollees and contacts the employee directly regarding invalid SSN".

- We would observe that the amount of responsibility placed on the record-keeper is most likely unrealistic in the sense that we are not aware that any such record-keeper currently exists. Furthermore, there is no discussion within the report of enrollee privacy and the handling of sensitive financial information per the Gramm-Leach-Bliley Act (and Patriot Act?).
- Will the recordkeeper be responsible for enforcing IRS maximum contribution limits if an employee fails to responds to the notification discussed in the report?

Page 16: The main recommendation calls for "…the Baseline scenario in terms of the default contribution rate (5%)…" and that "In particular, program financing requirements and expense ratios are highly sensitive to the default contribution rate. A lower default contribution rate entails significantly higher startup financing".

- This appears to contradict sections of the report that call for "no minimum" contribution. Therefore additional modelling is needed as noted above. That there is sensitivity between a 3 or 5 percent default contribution rate is clear, but without a minimum, modelling must be included for scenarios that dip below the "ideal" default rate.

Page 19: "Likely participation rates (70-90%) are sufficiently high to enable the Program to achieve financial viability"

- The participation rate and its correlation to financial viability is based on contribution amounts. How was the above conclusion reached, knowing that with no minimum contribution level it is that metric and not the percentage of participants that will drive success?

Page 20: There are a number of estimates and assumptions here, including that "A 5% savings rate invested in a balanced portfolio of Target Date fund yields a 20-23% average income replacement rate over a full career."

- Based on the mean $35,000 salary identified for the target market, can we really consider 20-23% income replacement (even when social security benefits are added) a "secure retirement"?
- The income replacement scenario described above assumes a full career and no pre-retirement withdrawals. The report does not address the results for an enrollee who only has time to participate for 5, 10, or even 15 years. It also does not address a large portion of the target demographic, which is part-time and seasonal workers with frequent work interruptions. Further modelling is needed and realistic expectations need to be communicated to enrollees.

Page 23: The report states "…that a significant share of eligible workers would be disinclined to participate if they cannot access their funds in emergencies".

- There is a disconnect here between the projected number of participants (low opt-out rate), the low leakage assumptions, and the fact that survey respondents overwhelmingly stated that they would not participate if they could not access their funds. How can the conclusion be made that participation will be high, even with suggested limits on pre-retirement withdrawals when participants indicated they would not be inclined to participate if they could not access their funds? The report becomes inconsistent when presenting these results.

Page 26: The report uses the United Kingdom's NEST (National Employment Savings Trust) as a model for participant behavior in automatic enrollment plans.

- Given the NEST requirement for employer and employee contribution, plus an unmentioned 1% contribution from the government (for a total baseline contribution rate of 7%), the NEST program does not provide a valid comparison.

Page 28: The report states that "Most communication between the Program and participants will be in written form."

- It is unclear within the report as to how that written communication will be transmitted. There are references to smartphones, website, and SMS, but no mention of the cost to physically mail paper copies to those that opt-out of all electronic forms. This is highlighted on page 36: "Because low-income participants are harder to reach via the online panel surveys". Furthermore, the report also identifies a significant portion of prospective enrollees wishing to have access to a help line via telephone, yet there is no mention of bi-(or multi) lingual language assistance for those with limited English proficiency. Who would be on the other end of the line? Trained investment advisors? These costs merit further analysis.
- We note that the report does not foresee or describe a role for the thousands of independent agents and advisors in today's market. We believe that these agents should play a vital role in the design of the program and that the report would benefit from their firsthand experience and understanding of the market and target audience.

Page 34: The report indicates that "In the case of a Roth IRA default, these [very high income] workers need to be instructed to re-characterize their contributions as traditional IRA or to stop contributing altogether. They should be notified of these options during auto-enrollment in order to minimize record-keeper costs".

- The report consistently points to the record-keeper as the liaison with enrollees, yet in this particular case the point of contact is not mentioned. By whom will this group of enrollees be notified of the tax consequences of their auto-enrollment? How will the marketing materials differ for this segment of the target market?

- Furthermore, how will this group of enrollees be identified, especially given households with multiple earners?"

Page 39: The report states that "…focus group findings are suggestive rather than definitive because of their small sample size".

- We agree, yet the conclusions drawn by the report are based on the answers of this small sample size and are too broad to encapsulate the real world scenarios of the "6.8 million eligible worker population" identified on page 27.
- Furthermore, some of the findings reflect conflicting viewpoints and beg for follow up question(s) that were not asked. For example, on page 39 it states that "many focus participants, especially low income ones, feel that they cannot afford to save", and that "However, most say they want to save and would do so if given the opportunity". The logical follow up questions that seem to be missing are 1. Do you have a bank account 2. Do you have a savings account 3. What is your estimated income to debt ratio and 4. How would you define an "opportunity to save". 5. Why are currently available savings vehicles not being used?
- We would recommend further sampling and a deeper dive into this research.

Page 40: The report touches on challenges uncovered during the focus group, including those related to "low income Spanish speaking population", "a lack of trust that many have of financial institutions" and being "overly risk-averse as a result of their limited financial literacy".

- We agree that these challenges are daunting, but the report does not offer solutions to these challenges, not the least of which is a seemingly significant mistrust of government and low financial literacy rates. The report does not address the shortcomings of a state sponsored retirement plan that proposes to offer written communication in English via mainly on-line and technology driven portals.

Pages 42-45: the report summarizes the on-line survey results, yet does not draw attention to some of the inconsistencies raised in some of the points above. For example, "43% of those with a 5% deferral rate would ask to lower it".

- This is a large enough percentage in our view that further modelling should be considered relative to the program sensitivity to startup financing and long term success when participants choose to lower the default rate since there are "no minimums".

Page 47: The report states that "the rate of pre-retirement withdrawals from the Program is likely to be higher than in the 401(k) world", but that "…the turnover resulting from job changes will be significantly lower in the Program than in 401(k)s" and that therefore "…the estimate is for 3.5% of plan assets" being withdrawn each year.

- We recommend more modelling to reflect real world changes that affect these assumptions. One could certainly imagine that with no withdrawal penalties (if structured as Roth IRA accounts) or with a hardship allowance, the pre-retirement withdrawal rate would be higher, especially for part-time and seasonal workers, a key portion of the demographic. A complete analysis must envision every scenario, and in this case the assumptions are simply too simplistic and optimistic in our view.

Page 47: The report highlights interviews with certain stakeholder groups.

- Was there a reason that the financial services industry was not included at all?
- In particular, there are references on page 78 of the report that grossly miss-represents the cost of certain investment vehicles offered by some of our member companies. This oversight then raises the concern that certain investment options were unfairly dismissed by the consulting team without factual evidence and perhaps without adequate research.

Page 50: The report casually remarks that "Often, the smallest businesses can only be effectively reached with "boots on the ground" – for instance, door-to-door outreach in neighborhood business districts".

- It is concerning to us that the report would mention what is undoubtedly a worthwhile endeavor but not discuss the cost or time requirements of such an enterprise. Furthermore, it raises a number of additional questions as to whether or not these "door to door representatives" would need to be trained or licensed, and how success could be measured. Would they be treated as investment advisors to the businesses or employees? How would liability be transferred if information is incorrectly transferred, etc?
- We again raise the need for agent and advisor involvement. The success of the California Health Benefits Exchange relied heavily on the relationships of local experts in their local communities and we would encourage their involvement in this design.

Page 52: The report clearly highlights an issue mentioned above: "A paper statement option in addition to online access is important for many low-wage workers, and written communications should be available in many languages".

- Based on the experience of member companies, we would agree, yet again question the thoroughness of the report, which fails to mention possible solutions to both these challenges and the estimated costs of providing multi-lingual paper statements.

Page 60: The report offers one model for a 40 year career during the accumulation phase, followed by a payout phase that predicts 37% income replacement from Social Security and 22% income replacement from "plan benefits".

- While we applaud the Overture team for using income replacement as a principal consideration in evaluating the various investment vehicle options, we think it is necessary to include modelling for non-"perfect" scenarios. What does the model look like for participants who only have 5, 10, 15 or even 25 years before retirement? Furthermore, what would the model look like if there are interruptions due to job loss, leakage due to hardship withdrawals, staggered contributions into Secure Choice due to job changes and employers that may have a separate plan for their employees, or even a voluntary opt-out for a period of time to make ends meet? The illustrated example is unfortunately far too optimistic in the assumption that even if someone were auto enrolled at age 25, they would faithfully contribute for 40 years without missing a payment in order to receive the projected benefit levels. This is especially true given the many part-time, seasonal, and temporary workers in the target demographic. Perhaps most importantly, the model included in the report does not identify potential liabilities that could significantly diminish projected income replacement ratios. The model further assumes that the individual has qualified for enough Social Security "credits" to receive the full benefit, which may not be the case in the event of job interruptions or other significant life events.

A person retiring with what they believe to be a comfortable nest egg that also has outstanding debt, health or lifestyle restrictions, and/or unforeseen dependent care may need a much higher income replacement ratio than the one projected in this model.

Page 65: The Report provides a very rapid overview of the "payout phase", recommending broad authority and that "Authorizing legislation should give the Board flexibility to determine payout."

- Given the projected size of the target audience, and the individual nature of retirement planning, we would strongly agree that the payout determinations should not conform to a "one size fits all" approach. While annuities are a very viable financial tool for some, they may not be the optimal vehicle for others. This emphasizes the need to educate enrollees on the choices that they need to make as they approach retirement years, with an understanding that this particular cross section of the population will need as many financial literacy tools as possible.
- We would again note that certain investment products currently available on the private market were given unfavorable treatment in the report yet may provide the most suitable option to certain subsets of the target population. For example, participants who enter the program with only a few years left until retirement may be better served by an annuity product that provides guaranteed lifetime income versus a pooled IRA in which a portion of their returns is diverted into the buildup phase of the reserve fund.

Page 79: The report identifies the "top two recommendations for the default investment option for California Secure Choice at launch" as being "Dynamic Asset Allocation Target Date Investment Strategy" or "Pooled IRA with Reserve Fund".

- We would question why the scoring methodology was based on a series of metrics (Product Score, Implementation Risk Score, Implementability at Launch and Suitability under Auto-Enrollment) yet appears to only have been modelled for the ideal candidate. Using a 25 year old participant with a 40 year career seems counter-intuitive for any prospective participant entering the program before the year 2057. The model assumes uniformity amongst participants but does not reflect what must be vastly varying scores in a true model reflecting the diversity of the identified target population. This is underscored on page 72 of the report for the pooled IRA with Reserve Fund option as "First generation sacrifices some returns to build reserves".

- For participants that do not have 40 years before retirement, Target Date Funds or a Pooled IRA are not the best choice. As identified on page 27, only 35% of the target population is under 30 years of age.
- How do the other 65% (4.4 million people) of participants fare under this scenario?
- Who will inform these first generation participants about the potential loss of returns? How does this information affect opt-in/opt-out rates? Why was the concept of a Pooled IRA with reserve fund not tested in the focus groups or on-line survey?

Page 84: The report identifies "The Workaround" of the Federal Regulatory Constraints of Pooled Investment Vehicles (PIVs) which "may require federal registration under the Investment Company Act of 1940.

- Without lengthy analysis of the statement referenced above, we are concerned that there is no mention of the Securities Act of 1933. This is another example of our belief that the analysis provided by this report must be further scrutinized or developed in such a manner as to be complete.
- Furthermore, there is no mention, or analysis of the scenario in which employers or employees cross the ERISA line, co-mingling ERISA monies into an "ERISA exempt" state run plan where earnings are held back to build a reserve fund. This scenario is highly probable given the desired portability of the program and the hand off of contribution tracking to the individual enrollee, yet receives no analysis in the report.
- Should existing employers that offer ERISA qualified 401(k) plans choose to shift to a Secure Choice plan, how would roll-over funds be treated, and vice versa?
- The SCIB raised this concern in their letter to the Department of Labor dated January 12, 2016: "The Proposed Safe Harbor suggests that such non-mandated employers could cause an entire program to fail the safe harbor and become an ERISA plan, with potentially disastrous consequences for the thousands of participating employers and millions of employees." Yet the report is silent on this critical component.
- Small employers are bound to fluctuate in size and rise above or fall under the 5 employee limit. The SCIB letter notes that employees not subject to automatic enrollment will "simply stop contributing." How does that dynamic affect Overture's projections for the hypothetical 25-year-old worker who is with an employer that fluctuates in size?
- The SCIB letter summarizes this concern perfectly: "Unfortunately, the behavioral studies conducted for the Board demonstrate that if switched to opt-out many employees will, instead, simply stop contributing. This problem will be compounded for workers employed by small businesses with a variable headcount--in some years meeting the five employee threshold and in others having fewer than five. The resulting roller coaster of opt-in in one year, opt-out in another will cause unnecessary confusion, increased administrative costs and likely lead to mistakes."

Page 85: The report states that "We used a 70% equities and 30% bonds asset allocation for modelling purposes. Assuming no seed capital, we recommend a more conservative investment policy (e.g. 20% Equities and 80% Bonds) for the first 3 years of the program."

- Why would an aggressive allocation strategy be modelled if not simply to show best case performance when the more prudent model should revolve around worst case performance?
- We do not understand the statement "assuming no seed capital". Where would such capital come from? And why is it never identified? Does the statement imply that the modelling includes seed capital?

Page 88 & 89: The charts compare the two top program investment options with certain assertions.

- Again, the model only shows "5% contribution rate, 42 year career". Where is the comparison with a lower contribution percentage and shorter career?
- Are the percentages in the chart suggestive of investment returns for participants?
- The statement that "Savings bond concept is intuitive but crediting policy may not be" needs further analysis. The concept was not discussed or identified by the focus groups or on-line survey. It would appear unbelievable that a very low financially literate population would grasp such a concept "intuitively".
- The modeling presented in the report and conclusions drawn from it almost make this Pooled IRA with Reserve fund concept unbeatable. If so, why is not in use today, and why has the Federal Government not adopted it to smooth the Social Security Program?

Page 91: The report identifies the administrative portion of the Program as the largest cost item and biggest determinant of financial feasibility. It furthermore asserts that "The recordkeeper is responsible for managing the day-to-day operations of the plan including the maintenance of individual accounts and keeping track of transactions and assets at the individual participant account level. A recordkeeper is also responsible for enrolling participants, tracking participant contribution rates and investment selections, providing account statements, maintaining the plan website and providing general support to participants and plan sponsors/employers."

- It appears extremely challenging to find such a recordkeeper in today's market.
- There are no provisions in the report that examine how such a recordkeeper would handle privacy concerns, sensitive financial information, data security, non-English language assistance and a host of other consumer protections likely to be imposed on any state administered program.
- Lastly, page 101 of the report calls for a recommended direct service operational model and subsequent development of an RFP. Perhaps it would be more prudent to develop an RFQ to gauge the capabilities of respondents given the tasks being assigned to the recordkeeper under the proposed operational model.

- Who would bear the risk and liability of recordkeeper error? How does this impact the fee structure and cap?
- If a separate hardship withdrawal program is established, who would administer it and again, how does it impact program fees and the 1% cap?

Pages 102-108: the report proposes "plan rules and procedures"

- It seems highly premature to delineate this level of detail given the uncertainties discussed above and the need for additional scenario modelling. The conclusions raised in this section again only apply to best case modelling with a number of trigger events such as Department of Labor approval of "grandfathering employers".

Page 110: The key findings state: "The Secure Choice Program is financially viable and self-sustaining even under adverse conditions with poor investment returns and high opt-out rates".

- The report itself identifies sensitivity to the default contribution rate but does not model anything below 5%. It is a likely scenario that with a default of 5% but no minimum contribution, the contribution rates will fall below the "ideal" modelled in this report. We would like to see this analysis developed in more detail.
- The "conservative assumptions of the Baseline Scenario, with a default contribution rate of 5% and an opt-out rate of 25%" achieves a "scale by the first year of operation with 1.6 million participants and over $3 billion in assets". Rough math results in an average account balance of $1875 (or 5% of $37,500) which is a much higher figure than the mean or median wage and salary identified elsewhere in the report.

Page 112: The report states that "we opted to make assumptions which we felt were 'conservative' in nature and "assumed an average annual pay rate of $45,000 for full-time workers and $20,000 for part-time workers".

- These numbers appear to be inconsistent with those reported elsewhere in the report, and note that per capita income trends in California have ranged between $30-35,000 per year in the past decade, and we therefore must question the choice to use a significantly higher number as the average.
- The report mentions separate modelling for full and part-time workers. Why was this done and how do the models included in the report compare when these populations are combined?

Page 113: The report calls for "a four year phase-in schedule" of the "approximately 285,000 employers" with eligible employees, with phase in assumptions of "46% entering in year one, 27% in year two, 17% in year three, and 10% in year four."

- The report does not account for the possibility of employers seeking to comply with the mandate for employee coverage by seeking alternatives to the Secure Choice Program. The totals listed above reflect 100% participation over the four year phase in. We strongly believe that market competition will cause a portion of these employers to set up and administer retirement plans for their employees that comply with any future state law, either through Multiple Employer Plans (MEPs) or traditional 401(k) vehicles.

- While we note that the report indicates that sensitivity analysis is not heavily impacted by opt-out rates and that the primary driver is the default contribution rate, we nevertheless believe it is necessary to model scenarios in which Secure Choice is not the preferred alternative for mandated businesses.

Page 117-119: The report identifies "expense drivers under the Baseline Scenario".

- None of these cost drivers are related to outreach, education, and awareness. Without making any specific comparisons between the two, we simply note that a February 2016 State Audit of the Covered California Health Benefits Exchange includes (for FY 2014-2015) an "outreach & sales, marketing" budget of $189,831,459.
- Similarly, the Exchange has a line item budget for "service centers" in the amount of $97,022,224.
- Again, without making any direct comparison, we note that the effectuated enrollment numbers for Covered California in 2015 was 1.47 million enrollees.
- This comparison serves only to highlight the point that the Overture report requires further detail and analysis with respect to the financial feasibility of the program. A number of the points listed above, including the desire of prospective plan participants to have phone access, paper statements, and multi-language assistance should certainly merit further study.

We respectfully submit these comments and questions in the hope that further study can be completed. There are a number of aspects that merit additional detailed analysis by the board and staff.

In addition to the specifics listed above, a number of critical decisions remain in the hands of the Department of Labor (DOL). While positive resolution of these barriers is possible, it is perhaps premature to assume their conclusions before official action.

For instance, how does the Overture study account for the possibility that the state will not be able to delegate responsibility for program administration to "money managers, record keepers and other third parties"? Just like retirement plan sponsors in the private sector, won't the state itself be liable to participants for mistakes and mismanagement by its vendors? How does the Overture study account for the cost of these potential liabilities?

The DOL safe harbor rules also require that "[t]he state assumes responsibility for the security of payroll deductions and employee savings." What safeguards will the Board need to put in place to ensure this responsibility is met? If the employer fails to properly collect or remit contributions, how will the Board or state "use its police powers to enforce its laws, correct such improper activity and punish wrongdoers"? Shouldn't the cost of this policing be reflected in the Overture study?

Also, the DOL safe harbor rules require that "[t]he state adopt measures to ensure that employees are notified of their rights and creates a mechanism for the enforcement of those rights." Has Overture studied the cost and methods by which the Board will enforce employee rights? The Board's January 12 letter notes that "California and many other States will develop an ERISA-like internal program claim system" to enforce worker's rights under the program. Should Overture study the cost of this dispute and claims resolution process given that it is an integral part of the program? Would a system of disability eligibility and payments have to be established under the program in a manner similar to that of social security recipients who become disabled prior to retirement and can no longer work?

For all these reasons, ACLHIC and ACLI would urge that the board continue its work and further refine these concepts. We stand ready to assist and provide our industry's experience and expertise to help the board identify a sustainable program capable of withstanding the test of time and effectively aid the millions of Californians in need.

Please feel free to contact us if you have any questions or need any additional information regarding our position.

Sincerely,

Brad Wenger

John Mangan

Brad Wenger
President & CEO
ACLHIC

John Mangan
Regional Vice President, State Relations
ACLI

Cc: Members, California Secure Choice Investment Board (SCIB)
Christina Elliot, SCIB Executive Director
Kevin de Leon, California Senate President Pro-Tempore

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March 4, 2016

Ms. Christina Elliot
Acting Executive Director
California Secure Choice Retirement Savings Board
Office of State Treasurer John Chiang
915 Capitol Mall, Room 110
Sacramento, CA 95814

Re: Comment on the Final Report to the California Secure Choice Retirement Savings Investment Board – RFP No. CSCRSIB03-14

Dear Ms. Elliot:

The American Retirement Association ("ARA") is writing to comment on a recommendation contained in the final report[1] to the California Secure Choice Retirement Savings Investment Board. The ARA thanks the Board for the thought, time, and work put into the implementation of legislation enacted in 2012 that authorized the consideration of the California Secure Choice Retirement Savings Program. The completion of the program design, market analysis, and financial feasibility study represents a key milestone that enables the state legislature to consider further legislation to implement the Program.

The ARA is a national organization of more than 25,000 members, including over 1,600 members in California, who provide consulting and administrative services to American workers, savers and sponsors of retirement plans and IRAs. ARA members are a diverse group of retirement plan professionals of all disciplines including financial advisers, consultants, administrators, actuaries, accountants, and attorneys. The ARA is the coordinating entity for its four underlying affiliate organizations, the American Society of Pension Professionals and Actuaries ("ASPPA"), the National Association of Plan Advisors ("NAPA"), the National Tax-deferred Savings Association ("NTSA") and the ASPPA College of Pension Actuaries ("ACOPA"). ARA members are diverse but united in a common dedication to America's private retirement system.

The ARA wishes to comment on the report's recommendation that California policymakers should consider whether the Board should have discretion to establish a multiple employer plan (MEP) at some future date in order to receive voluntary employer matching contributions. The ARA strongly disagrees with this recommendation.

The ARA, as ASPPA, was actively supportive of the effort to enact the California Secure Choice Retirement Savings Trust Act in 2012. In fact, the ARA has consistently and actively supported proposals to expand retirement plan coverage in the private workforce through state based automatic enrollment IRA proposals that require employers who do not offer any other

[1] California Secure Choice Market Analysis, Feasibility Study, and Program Design Consultant Services – RFP No. CSCRSIB03-14 prepared by Overture Financial LLC (February 9, 2016)

retirement savings arrangement to automatically enroll employees in a state-based auto-IRA program. The ARA believes that this approach increases access to and use of payroll deduction retirement savings while placing as minimal a burden as possible on both the employer and the state.

However, the creation of a state based qualified retirement plan of any type, including a MEP, should be rejected, because California should not compete with its own small, private businesses for no reasonable purpose. In California, the marketplace for qualified retirement plans, like 401(k)s, as well as SIMPLE IRAs or other retirement savings vehicles, is robust and highly competitive. California's private service providers compete in this market, create jobs, and pay taxes. The recommendation would allow the state to compete directly with these private service providers even though small businesses already have many low-cost options to provide qualified plans to their employees.

In addition, a MEP for private employers would be subject to ERISA in addition to the coverage and nondiscrimination requirements of the Internal Revenue Code. There would be a substantial administrative and liability cost to the state. There is a long list of responsibilities for the service provider – in this case, the state – for each employer participating in the qualified plan. These responsibilities include: (1) determining business ownership; (2) gathering payroll data and determining if the right elements of pay have been included or excluded; (3) reviewing reported hours worked for reasonableness, and using that information to determine which employees must be included in testing and contribution allocations; (4) determining key and highly compensated employees; (5) completing discrimination and top heavy testing; (6) processing refunds to correct any failed testing; and (7) allocating employer contributions according to the plan's formula as well as completing required federal filing and notices. Other services that must be provided on an ongoing basis include distribution processing; document processing for adopting employers and amendments to keep the plan in compliance with federal law. Because the state would be selecting the investments and record keeper, California would become a fiduciary for the plan covered by the program and would need insurance covering its exposure. The state will not be able to eliminate its responsibility for the risk of non-compliance by contracting with a third party.

The state based MEP recommendation contained in the final report is a well-intentioned, but bad idea. The creation of a state based qualified plan, including a MEP, for private employers will not solve a real problem, but it would result in substantial cost and liability for California and could hurt businesses in California that provide retirement plan services. Legislation enabling the California Secure Choice Retirement Savings Trust should not include authority to establish a MEP, or any other ERISA arrangement, for private employers.

Sincerely,

B. H. Graff

Brian H. Graff, Esq., APM
Executive Director/CEO
American Retirement Association

Dear Ms. Elliott:

I take the liberty to reach out to offer some comments on CA Secure Choice as I have been involved in pension reform efforts globally for close to 20 years. I am currently an Academic Scholar at Kathleen Kennedy's Georgetown University Center for Retirement Initiatives, but was also a consultant to Overture for your study, and was invited to speak to the CT Retirement Security Board about their reform. I am also a Founding Advisor for the University of California's Defined Contribution Plan. By way of background, I have been managing pension assets for over 20 years (including those of some of the most sophisticated CA public funds) and wrote a book on reforming Social Security with Prof. Modigliani (a Nobel Prize winner) in 2004. My comments are strictly personal and do not represent those of any of the organizations I am affiliated with.

The reason for reaching out is that I feel that many academics and interested parties to the reform have been recommending investment models which are guaranteed to fail if used by CA Secure Choice. As I discussed with CT's Retirement Security Board, if the goal of the Secure Choice reform is to provide individuals with a target, guaranteed, inflation-adjusted retirement income for life, then existing instruments and approaches (including Pooled IRAs or target income solutions) cannot provide such an outcome at low-cost, low-risk, in a simple manner and with the liquidity desired by CA citizens (as indicated in the study Overture conducted). Based on my experience working on the CA reform and other reforms, I have suggested that the US Treasury needs to issue a new bond (see attached one page Op-Ed in Pensions and Investments), and thanks to Kathleen Kennedy and Hank Kim, have had preliminary discussions with US Treasury officials. A more detailed paper is available online (http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2680282), but unless states like CA and CT lobby for such an instrument, it will never be introduced, and your citizens will be exposed to the vagaries of the market, will pay steep costs, have to engage in complex transactions and enter into illiquid annuity contracts.

I trust this information is useful and I am available to help in any way possible as I would hate to see these reforms go the way of the privatization of Social Security systems globally (as Prof. Modigliani and I had forcasted); namely, that they transferred monies from poor citizens to rich Wall Street firms.

Thanks in advance and good luck with the reforms.

Best regards

Arun Muralidhar
Adjunct Professor of Finance
George Washington University School of Business
Washington DC

March 10, 2016

California Secure Choice Investment Board
915 Capitol Mall, Room 110
Sacramento, CA 95814

SUBJECT: Public comment on final Report to the Secure Choice Retirement Program prepared by Overture Financial LLC

Dear Chairman Chiang and Board members.

During the legislative process of Senate Bill 1234 (Chapter 734, 2012), the authorizing statute enacting the California Secure Choice Retirement Savings Program, the employer community expressed significant concerns with the proposed plan. Although we ultimately removed our opposition, we did so to allow a feasibility study to be conducted to fully explore our concerns regarding the implementation and operation of the program. This study has been completed by Overture, and this letter both represents our comments on the findings contained in their report (report) and expresses our coalition's remaining concerns with the recommendations for implementing the program.

The Secure Choice program must be easy for employees and employers to understand, easy to implement and easy to comply with its requirements. Employers must not be exposed to risks for employee assets or investment choices and must not face traps that could cause inadvertent liability. The coalition finds that the report oversimplifies the processes and procedures that employers will be required to complete, makes assumptions that may or may not materialize regarding the recordkeeper function under the direct service model, and fails to adequately and completely identify and address risks and liabilities for employers.

Furthermore, the coalition must note that our requests to Overture to discuss our concerns directly with them went unanswered, and the concerns that were communicated to the board through public comment and letters were neither adequately raised nor addressed in the report. For example, employer groups assert that the statement on page 102 indicating input was sought from stakeholders is not fully accurate. While one phone call from the consultant was had with two employer group representatives that are members of this coalition, broader input was not sought from equally impacted business groups.

Following are a number of concerns raised by our employer community coalition regarding risk and program administration that we urge the board to address, and reflect in the final program design.

Federal Law Impact

ERISA Applicability. Because one of the employer community's primary concerns during the legislative process was with the application of ERISA both to the plan and employers, SB 1234 explicitly acknowledges these risks and was amended to reflect that further study and assurance were required. The law states as follows:

100043. 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 Internal Revenue Code, or if it is determined that the program is an employee benefit plan under the federal Employee Retirement Income Security Act.

The coalition has significant concerns with the inadequate attention given by the report to ERISA and to program compliance with the DOL regulations, as proposed or otherwise. Given that the enabling legislation prohibited the implementation of the program if ERISA applies, the analysis is incomplete.

Further, the report states on page 49 that only two organizations were concerned about potential liabilities to employers related to ERISA and asserts that employers have merely four concerns, not one of which is the concern regarding ERISA liability. We are concerned that the ERISA risks were not accurately attributed to employer stakeholders perhaps because Overture has assumed that the DOL will provide airtight protection on this matter to employers. Therefore, we find it disingenuous to say that because only two employer organizations were acknowledged as having concerns, since all employers will share the risk, and conclude that this concern was not given its due significance and attention, especially in light of DOL's admission that their safe harbor may in fact not provide complete security from risk and liability, as discussed above. The report merely acknowledges this as an "other issue" for the board to consider (page 50), but the report does not provide any guidance or recommendations regarding the issue.

Proposed DOL Regulation. While the program has not been determined to be "…*an employee benefit plan under the federal Employee Retirement Income Security Act,"* it also has not been determined that the program is not nor will not be subject to ERISA. Although the federal Department of Labor (DOL) has proposed draft regulation to "reduce the risk of state programs being preempted," the DOL admits that the ultimate determination rests with the courts.

In fact, there is a risk of increased legal liability for employers that the guidance does not address. An employee or class action suit could challenge the safe harbor definition under this proposal and claim that the employers are subject to ERISA. If a violation of ERISA is found, the employers will have been unwittingly subjected to this increased liability without any recourse against the state or the DOL. Furthermore, it is unclear that if a determination of ERISA pre-emption is found if it would be applicable to the entire program or to the specified employer(s).

Additionally, what would happen if some ineligible employers intentionally or inadvertently "sneak" into the program and auto-enroll their employees, or if legitimate employers maintain enrollment when their employee count drops below the mandated threshold. While we understand this may be a desirable outcome for the board, the proposed safe harbor suggests that such non-mandated employers could cause an entire program to fail the safe harbor and become an ERISA plan, with potentially disastrous consequences for the thousands of participating employers and millions of employees. the state cannot fully vet all participating employers for eligibility and continue to keep operating costs to a minimum.

Importantly, the proposed regulation does not include clear detail that specifies what the "ministerial duties" are on the part of employers in order to make sure employers clearly understand their limited duties and do not inadvertently become subject to ERISA and the requirements there under. Our coalition is very concerned that if the state follows the guidance but an employer inadvertently provides more than ministerial duties, it could put all employers in the position of being covered under ERISA and at risk of legal liability.

Employer Outreach and Education

Key to the success of the program is the full participation by eligible employers, which will require extensive outreach and education in advance of implementation. Furthermore, employer understanding of the all the nuances of the program and the role of the employer is essential in order to facilitate a satisfactory experience for the employee. This program component is not given adequate attention in the report, while employee outreach and employee protections are given significant weight.

Integral to the success of the program is employers' ability to adequately understand the program rules and procedures, including a complete understanding of their "*ministerial*" responsibilities. Success also depends on employers' ability to understand and prevent exposure to ERISA and other liabilities, including how to safely interact with employees in accordance with DOL's guidance (which has not yet been provided in the proposed DOL regulation or in the report recommendations). Given the potential for significant risk to employers and the program, the coalition urges the board to require extensive, immediate and ongoing comprehensive education and training for employers prior to any program activities on the part of the employer, including prior to beginning employee enrollment.

For the protection of the employer and the employee, as well as to facilitate enrollment and satisfaction with the program experience, it is essential that employers have a website and hotline available 24/7 for customer service. Ready access to information will decrease employer's chance of mistakes. Keep in mind that small businesses in particular tend to work long hours, handling administrative duties after normal working hours. To minimize business disruption, access to specialists must be available during extended hours.

The coalition recommends that the board be clear about the specific dynamics used in calculating the cost of employer outreach, and on how this expense will be covered. Materials must be designed, printed, distributed, posted to websites and updated regularly. The diversity of industries and employer size may require differing approaches and materials. The coalition strongly encourages officials to make in person as well as webcast presentations to employer groups. Consequently, there will be significant costs involved. In reviewing the report, we do not see how this cost is addressed, and leaves us with questions. Have these costs been included in program start up estimates? Is it part of the administrative costs? Will employers and employer associations be expected to bear any costs of outreach? Have the associations indicated in the report been contacted to discuss this outreach as recommended in the report? If EDD is to assume costs, is that included in the administrative costs of the program – the 1 percent charged directly to the program? If it is not, where will the money come from – General Fund, employers, investors, vendors?

Employee Outreach

The report recommends a concerted, aggressive public education campaign focused on workers and small businesses. We agree this outreach and education of employees is very important. Employee access to information is also critical to the success of the program. The more education and access the employees have, the greater the chance to eliminate the provision of information, counsel and advice by the employer. In order to protect employers – employees must be completely informed.

Given the lack of investment sophistication of the program's targeted population as identified by the study, employees must have easily understandable and readily accessible information that covers all aspects of the program including the fundamentals of process, procedure and investment risk and reward. Information must be easily and consistently accessible, especially in-person – either face to face or via telephone access. Key recommendations of the report omit (or downplay) the key financial education that employees will require, and instead focuses on granting employees with enforcement and compliance powers targeted at the employer.

Rules and Procedures

Regardless of how simple the report insists the process will be for employers, there are many steps and rules the employers must understand and follow. The rules and procedures recommendations fail to acknowledge and address the complexities of the employer duties, responsibilities, and risks. Furthermore, the report fails to specify what the employer's "ministerial duties" are limited to, leaving employers at risk of ERISA pre-emption. Below are just a few of the many concerns the coalition has regarding rules and procedures that are not enumerated.

- **Employer Eligibility**. The terms "firm" and "establishment" that are proposed for determining employer eligibility requires more specific definition in order to avoid confusion and liability.

- **Employment Intermediaries**. The report suggests that these intermediaries be responsible for compliance. This recommendation requires more detail and a discussion of its underlying assumptions, for example, in the context of professional employer associations.

- **Employer/Employee Interaction**. Interaction about the program must be limited between employers and employees in order for employers to prevent risk and liability under ERISA, and any other laws that may pertain. Employers need specific instructions. The report fails to acknowledge and address these rules.

- **Enrollment Process**. The report fails to adequately address the issue of ineligible employers (as defined in the proposed DOL rules for the safe harbor from ERISA) participating in the program.

- **Signature Requirement**. The report recommends a signature from the employee acknowledging receipt of program information and then retention of those records. Will the employer be required to collect these signatures and maintain the documentation? What happens if an employee does not sign?

- **Employer Customer Service**. Employers must have access to not only online assistance, but readily accessible in person assistance by telephone.

- **Hidden Burdens and Costs**. The operational model in the report (page 92) states "processing volumes should be spread evenly over the period (e.g. no month-end, quarter-end spikes). The report does not consider that most employers process at month-end and quarter-end. Changing their process calendar could be a major administrative burden. If in fact the recommended model requires employers to add administrative processing at a different time than other administrative processes, this needs to be considered and thoroughly addressed from a feasibility and cost perspective. Adding a payroll processing function each month could also trigger new costs in addition to the administrative burden.

- **Employer Audit**. Operational model features (page 99) show that EDD will audit employer eligibility. What does this mean? How is this paid for?

Enforcement against employers

The coalition has serious concerns regarding the enforcement component. This provision has not been made clear enough. It is our understanding that discussions have occurred with the Department of Industrial Relations (DIR) and their ability to address enforcement against employers. A primary concern for California employers is that additional enforcement functions for DIR will require an increase in assessments on employers since the Department is supported by a fee on employers.

Further, it is imperative that enforcement policies differentiate between employers who make technical, inadvertent mistakes due to a misunderstanding or lack of awareness, and those who have not enrolled employees, and those who purposefully violate the program rules and engage in practices such as wage theft. Those employers that do make procedural mistakes should be given time to correct those errors prior to any enforcement action. We also urge the board to consider delaying any enforcement against employers until such time that all eligible employers have transitioned into the program and have been fully educated about their role and responsibility under the program.

Roth IRA vs. Traditional IRA

While the report insists that the number of participants potentially ineligible for a Roth IRA is “small,” based on the report’s projections, that number exceeds a half a million participants (8 percent of participants) – not an insignificant population. The recommendations require participants to be responsible for tracking contribution limits to a Roth IRA in relation to their income. We point to this target population as significant and the implications to them and their employers deserve more attention.

The coalition is concerned that the employee has a tremendous responsibility to track their eligibility for the proper investment vehicle. It is imperative that the employee be informed of how to determine and maintain their eligibility for a Roth IRA, and how to switch to a traditional IRA. In such a circumstance, the employee will almost certainly approach the employer (if they even know there is a potential for ineligibility) to help them figure out their eligibility. It will not only be those employees that are possibly ineligible, but other employees who seek to know if they are or are not eligible. The report recommends that the employee be responsible for identifying which IRA they are eligible for, and then to track their contributions. All operational aspects of this uncertainty must be specific and eliminate risk and liability for the employer particularly under ERISA.

The feasibility study indicates that the target population for the program has limited financial literacy which adds to the complexity of this feature. The eligibility requirements for one IRA versus another are complex. The assertion that a target participant will be financially literate enough to know if they are eligible or not for a Roth IRA is absurd. The understanding of eligibility and the selection of the appropriate investment vehicle by participants is severely under –rated by the report.

Recordkeeper concerns

Throughout the report, the recordkeeper is assumed or hoped to be capable of a variety of operations, excerpt below:

“Recordkeeping is the central operational function of a retirement plan and as such represents the largest administrative cost component. The recordkeeper is responsible for managing the day-to-day

operations of the plan including the maintenance of individual accounts and keeping track of transactions and assets at the individual participant account level. A recordkeeper is also responsible for enrolling participants, tracking participant contribution rates and investment selections, providing account statements, maintaining the plan website and providing general support to participants and plan sponsors/employers."

The coalition prefers an operational model that provides as much separation as possible between the employer and the participation and investment decisions of the employee, and that limits the employer's role to distributing program marketing materials to employees and processing their payroll contributions. However, the coalition is concerned that the recordkeeper role described in the report with the capability to process the anticipated number of participants may not exist or materialize, and that the cost of the record keeper function may be under-estimated. In the absence of a recordkeeper performing these functions, the employer functions are not enumerated and analyzed. It is important to understand the risks and implications in the event that one or more of these functions are not available from a recordkeeper.

Overture themselves state (page 92) "…new technology solutions coming to market" are needed to make their recordkeeping scheme work.

Furthermore, the recordkeeper verification of employee social security numbers and identity after receiving it from the employer, then having to contact the employee directly in the event of errors has potentially significant privacy implications, and potential Patriot Act implications.

Multiple statements in the report assume the recordkeeper will manage auto-escalation. What specifically does this mean? Is it anticipated that the recordkeeper will notify the employer or the payroll service when to increase contributions? The employer still would need to track and account for changes in payroll deductions. This is an administrative burden not adequately addressed by the report.

The report further recommends the direct service model with a recordkeeper and that the program hire a consultant to draft the RFP, run the RFP process and oversee the implementation of the operational model. How have these costs been accounted for in the start up costs?

Risk and Liability

An analysis of any risks to the program and their potential consequences, and how to minimize or prevent them is not part of the report. Many questions remain unanswered regarding potential risks and threats, and how potential problems could be addressed, such as:

- In the event of lost contribution and late contributions, who is responsible for any lost income by the participant? Who owes the money to the participant? What happens if year-end reconciliations are not accurate-if deductions do not equal contributions, either to the positive or negative?

- Are there legal requirements regarding the time lapse between the payroll deduction and the deposit into the investment account? Can these time lines be met? If not, what are the consequences? Who is responsible?

- Are there security and investment laws – state or federal - that govern the program that employers and the board are subject to and need to be aware of?

- Are there any privacy rules that employers need to be aware of and comply with?
- In the event the program is not self sustaining as anticipated, who is responsible for any shortfall?
- What are the risks to the General Fund, to the program, to the board and to the investors? What if the program is not self-sustaining?
- Should ERISA-like protections be afforded participants in this program? If so, which ones should be adopted into or eliminated from this program?
- What recourse do employers have if the "safe harbor" guideline are struck down by the courts or overruled by legislation from Congress? Will they be held harmless? What will happen to participants' contributions?
- If one employer, or a group of employers, are found to be preempted by ERISA as a result of doing what they were told was required for compliance and acceptable under this program, is the entire statewide program preempted? For example, if one or more employers fail to remit some contributions, or fail to maintain adequate records, does such noncompliance result in the state program becoming an ERISA-covered plan? Or, would that result in the non-compliant employer(s) having established an ERISA-covered plan? What is the liability of the board or the state under this scenario?
- Do any other options for retirement saving exist in the marketplace that would be less risky, less costly and would provide greater protections and better retirement security for employees?

Cost to Employers

In contrast to simplistic model portrayed in the report, the coalition has identified many decision and tracking points for employers, all of which not only create cost, but also potential liability for mistakes and lawsuits. Many of these concerns have been previously communicated to the board in written comments (September 21, 2015). Some of those concerns are repeated here, as they are not addressed in the report and we urge the board to consider them in their recommendations to the Legislature.

Employers will be tasked with calculating and verifying payroll deduction amounts that will be different for most employees. Some are likely to be fixed amounts, others based on various percentages of wages. As we understand it, the report recommends that the employee be able to revise their contribution amount to any amount, at any time. If there is a recordkeeper that acts as intermediary as proposed between employer and employee, the recordkeeper will be transmitting information to the employer on a regular basis that the employer must document and act upon, such as changes to contributions, opting in and opting out. This could be quite an administrative burden for employers, even employers with few employees. The coalition is concerned that the many moving parts of tracking and remitting payroll contributions could result in mistakes, and that those mistakes could wind up being costly for employers in terms of enforcement penalties, and could potentially result in exposure to legal liabilities.

The report states that several employers noted that the cost of compliance would be absorbed by employers as a normal cost of doing business. However, the cost of compliance was not disclosed and is still not known so this statement has no basis. We urge the board not to assume that this cost to employers is absorbable.

Conclusion

In conclusion, the coalition thanks the board for the opportunity to share our comments regarding the Secure Choice report prepared by Overture. While we appreciate Overture's insights and work to establish feasibility and to conduct the market analysis, we respectfully suggest that more study and analysis must be completed before any action should move forward. We have enumerated some of the points where the report falls short of providing the complete information the coalition believes the board needs to make informed decisions regarding the risk, liability and administrative functions required by employers in order to implement the program.

The coalition also notes that simple, cost effective private market solutions may be available and yet have not been explored. Perhaps there is a better path to addressing the "retirement crisis."

To discuss our comments in further detail, please contact Marti Fisher, California Chamber of Commerce (916)444-6670, or Nicole Rice, California Manufacturers and Technology Association, (916) 498-3322.

Respectfully,

California Chamber of Commerce
California Manufacturers & Technology Association
Allied Managed Care and Acclamation Insurance Management Services
Associated Builders and Contractors of California
California Building Industry Association
California Business Roundtable
California Chapter American Fence Contractors
California Construction and Industrial Materials Association
California Farm Bureau Federation
California Fence Contractors
California Framing Contractors Association
California Professional Association of Specialty Contractors
California Retailers Association
California Restaurant Association
Conejo Valley Chamber of Commerce
Flasher Barricade
National Association of Independent Business
National Association of Professional Employer Organizations
North Orange County Chamber of Commerce
United Chambers of Commerce
Western Manufactured Housing Communities Association

C: Christina Elliott, Executive Officer

BETTY T. YEE
California State Controller

March 7, 2016

The Honorable John Chiang, California State Treasurer
and Chair, California Secure Choice Retirement Savings Investment Board
915 Capitol Mall, Room 110
Sacramento, CA 95814

SUBJECT: Final Report of Overture Financial to the California Secure Choice Retirement Savings Investment Board

Dear Treasurer Chiang:

As State Controller, I greatly appreciate the opportunity to serve on California's Secure Choice Retirement Savings Investment Board ("Board") and work on a solution to begin to address the issue of retirement security. As we all know, too many workers throughout the state and the nation are without access to a retirement plan. For most of them, this means retiring can never be an option.

In accordance with the requirements set forth in Senator De Leon's SB 1234 (Ch. 734, Stat. of 2012), the Board is tasked with providing recommendations on whether and how to implement a state retirement plan option for non-public employees. The pros and cons of the eight approaches studied are set forth in the Draft Final Report to the California Secure Choice Retirement Savings Investment Board ("Report"). Two options, the Target Risk Fund and the Pooled IRA with Reserve ("Pooled IRA"), are both recommended.

For both the Target Risk Fund and the Pooled IRA, there is no guarantee and the participant bears all the risk. Pooled IRA may produce better long-run outcomes with lower volatility. However it has never been implemented before; there is administrative complexity; and the first generation will sacrifice some return to build the reserve.

To better understand the costs associated with these options, I respectfully request that the following additional information be provided in writing to the Board prior to our March 28th hearing:

1. Some of the most important assumptions for both the Target Risk Fund and the Pooled IRA option, include:

    - Median long-term inflation rate of 2.5%
    - Wage inflation of 0.5% (adjusted for inflation)

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www.sco.ca.gov

- Estimated U.S. bond compound return is 4.5% and for equities 7.9%.
- Ten Year Treasury Note – 4.25%.

Why is the 4.25% rate being used when the 10-year Treasury rate is currently 1.84% and the 10-year Treasury rate has not exceeded 4.25% since 2007?

In addition to the low Treasury rates, the three-year fixed income returns at both CalPERS and CalSTRS have been under 2.5%. What happens to participants' deposits if the assumptions are not met?

If wage inflation does not hit the assumed 0.5% do you expect participants to stop contributing?

2. On page 87 of the Report, Overture notes one of the trade-offs of the Pooled IRA, is in the early start-up years, some of the available returns will be diverted towards establishing the desired reserve level, and credits will not "flow" to participants.

   What impact will this have on participation? Was this clearly explained to and asked of the market study participants? What if the reserve does not accrue as hoped during the first few years? Should there be strong provisions to protect the Board from pressure from participants to credit accounts or increase credits over time?

   How would the Board address the equity issue with the first generation of participants who will pass on a share of their returns to the reserve fund? Is there a mechanism to make them whole when the Reserve hits a certain point?

3. The Pooled IRA fund option has never been implemented. Yet clearly this option entails Board fiduciary duties analogous to board duties at CalPERS and CalSTRS, with respect to investment policy and allocation decisions:

   If the Pooled IRA option is selected, what would be the estimated cost to hire a consultant to conduct the asset allocation study? Assuming this work would continue throughout the life of this program, should this cost be projected annually?

   Given the pooled nature of the investment program for the Pooled IRA, would the Board incur additional ongoing (annual) consultant costs analogous to those incurred by the State's pension funds to oversee and help inform the Board of investment performance, investment options, and any legislative directives on divestment?

Lastly, I would greatly appreciate an estimated cost comparison of the likely annual consultant, fiduciary counsel, and investment management fees, broken out by service provided, of a pooled program, so all of the costs of the pooled IRA option are identified clearly.

Thank you for your prompt attention to my request for the additional information specified above.

Sincerely,

Betty T. Yee

BETTY T. YEE

cc: Grant Boyken
Christina Elliott
Michael Cohen
Edward J. De La Rosa
Yvonne Walker
Cynthia Pollard
William Sokol
Marty Morgenstern
Heather Hooper
The Honorable Kevin de Leon, President Pro Tempore

Capitol Matrix Consulting
Analysis, Advice, Advocacy

March 24, 2016

California Coalition for Financial Security
1201 K Street, Suite 1820
Sacramento, CA 95814

Dear Coalition Member,

As requested, this letter provides our preliminary review of the report by Overture Financial entitled, "California Secure Choice; Market Analysis, Feasibility Study, and Program Design Consultant Services." We recognize that there are legal issues and issues regarding implementation and employer impacts that others have addressed. Therefore, our review focuses on the key fiscal issues related to the program.

Background

Chapter 734 of 2012 (SB 1234)[1] established the California Secure Choice Retirement Savings Program and Trust to be implemented by the California Secure Choice Retirement Savings Investment Board. The program would require employers of five or more employees, not otherwise exempt,[2] to deduct a portion of an employee's paycheck for deposit in a retirement trust to be overseen by the Board. It also authorizes the transfer of a portion of the trust's assets to an administrative fund to cover the operating costs of the program, and restricts expenditures from the administrative fund to less than 1 percent of program assets each year.

SB1234 also specified that the program will become operative "only if the board determines that, based on (its) market analysis, the provisions of this title will be self-

[1] Government Code Section 100000 et seq.

[2] Governmental employers are all exempt. The wording in the statute is ambiguous, but we believe its intent is to also exempt only those private sector employers who offer another qualified retirement plan.

sustaining, and funds are made available … in amounts sufficient to allow the board to implement this title until the trust has sufficient funds to be self-sustaining." In addition, the Act prohibits the Board from opening enrollment in the program until a subsequent authorizing statute is enacted that expresses the approval of the Legislature."

The Overture report addresses the market analysis and financial modeling requirements of SB 1234. While it contains impressive programmatic and financial detail, we believe there are key areas that deserve additional scrutiny before implementation of the program. These include: (1) important fiscal issues were not addressed in the Overture report, (2) the effect of real world issues on the idealized estimates of income replacement at retirement shown in the report and (3) impacts of important items excluded from Overture's financial modeling on the viability of the Secure Choice program.

Significant Fiscal Issues Not Addressed In Overture's Report

We have identified the following significant fiscal issues that we believe will need to be addressed by the Board, but which were either not raised or inadequately addressed in the Overture report.

Insurance requirement. The Assembly amended SB1234 before returning it to the Senate for final approval by adding Government Code Section 100013, which requires the Board to "ensure that an insurance, annuity, or other funding mechanism is in place at *all times* that protects the value of individuals' accounts" and specifies that "the funding mechanism shall protect, *indemnify, and hold the state harmless at all times* against any and all liability in connection with funding retirement benefits pursuant to this title." (Italics added for emphasis.)

The Overture report makes several recommendations to minimize investment risks. It also makes several recommendations that the Board seek amendments to the enabling statute for specific purposes. However, it does *not* address the explicit insurance requirement that accounts be protected at all times. Clearly, the requirement was enacted to protect both the participants and the state government and probably the bill would not have gotten out of the Assembly without the provision. This leaves two options prior to implementation:

- *Delete Section 100013*. This would put the issue of the state's risk (and the participants' risk) back in front of the Legislature. At that point, the Legislature could consider whether the measures proposed by Overture are adequate to protect the state from any potential future liability. With potentially tens or even hundreds of billions of dollars at stake, the Legislature would probably need a very high degree of certainty that its risk would be kept to near zero in the proposed program design. In the world of investment, risks near zero normally come at the cost of much reduced rates of return.

- *Price in the costs of insurance or annuitize the entire program.* The wording of 10003 suggests the need for an annually redetermined guarantee for each participant plus a general indemnification of the state. A market feasibility study conducted for a similar program contemplated by the State of Connecticut found that the protection of individual accounts at retirement age could be purchased at the rate of 100-200 basis points per year.[3] This protection would only apply to the account balances at retirement - not to individual years prior to retirement - and thus may not fully comply with Section 100013. However, even this policy would have a substantial impact on the rate-of-return assumed by Overture in its retirement analyses (over 6 percent). As to a policy indemnifying the state, we could not find any insurance product that is currently marketed for that purpose.

In our view, Section 100013 can not be implemented. There is simply no practical way to entirely eliminate the risk to the state from a program like Secure Choice. Moreover, in addition to the legal and investment risks, the program creates a significant political risk. Using Overture's best-case scenario, a worker after a 42-year career with uninterrupted 5-percent contribution rate would receive only 24 percent of her final pay as retirement income from the program, and as shown below, the actual income replacement ratios for most participants will be significantly less than that. To the extent that participants misunderstand this promise and misinterpret the new program as offering a more substantial retirement, future legislatures could come under great pressure to augment the program's retirement income. Mitigating this political risk would require a major public outreach and communication effort about the program.

Outreach and communication. In its first four years, Secure Choice will result in over 6 million employees having their pay checks reduced by 5 percent,[4] or having to exercise their option not to participate, or to participate at a lower level. Obviously, to prevent mass confusion and outcry as well as to encourage workers not to exercise their right to opt out, the state will need to conduct vigorous and extensive public outreach and a call center for direct communication with participants and potential participants. Indeed, one of the key themes to emerge from the focus group sessions summarized in the Overture report was the need for extensive outreach.[5] While the report acknowledges this need, the financial modeling assumes only $800,000 in the

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[3] http://www.osc.ct.gov/crsb/docs/finalreport/CRSB_January_1_Report.pdf

[4] While SB1234 does not establish a specific default contribution level, Overture is recommending 5 percent.

[5] For example, on page 53 of the report, Overture summarizes opinions and suggestions of consumer organizations and asset building groups as follows: "*Properly designed outreach and education that addresses the diversity and limited financial literacy of the Program market are important.* This includes working with organizations that understand how best to communicate with distinct markets and communities and drawing lessons from the Affordable Care Act rollout to understand how to promote trust in the Program, given that many low-wage workers have had negative experiences with government and the financial system."

first year and $400,000 ongoing for outreach[6] and only $1.2 million in the first year and $700,000 ongoing to the Employment Development Department (EDD) for a call center (which we understand is intended for employers, rather than employees). Also, the report provides no funding for the requirement that the Board "design and disseminate to employers through the Employment Development Department an employee information packet…(which must) include background information on the program and appropriate disclosures for employees."

The state has recent experience with outreach to, and communication with target groups similar to the target groups for Secure Choice, i.e., lower income, diverse, working populations. Specifically, the state recently implemented the Affordable Care Act program, which targets similar populations. Table 1 displays the initial funding proposals for outreach and call centers for this program (Covered California), its target populations and the costs per targeted individual.

We recognize that outreach to enroll and advise people in health care is different than outreach to advise workers of their options with regard to a new retirement plan. It is also the case that the program will be phased in, which will reduce annual expenses. However, even after (1) accounting for the phase in and (2) assuming Secure Choice outreach and communication could be adequately provided at *one-third* the per-person cost of what Covered California budgeted, the budget for outreach and communications would still be over $25 million per year during the phase in period.[7]

Table 1
Covered California Public Outreach and Communications

	Target Population *a/*	**Budget *b/***	**Cost per Targeted Individual**
Public Outreach	4.6 million	$102.6 million	$22.30
Call Centers	4.6 million	$121.0 million	$26.30
Total	4.6 million	$223.6 million	$48.6

a/Includes all potentially eligible population, including those potentially eligible for subsidized and unsubsidized coverage under Covered California as well as those eligible for Medi-Cal under both pre-and post expansion criteria. Source: https://www.coveredca.com/news/PDFs/CoveredCA-Enrollment_Projections-9-30-13.pdf, figure 2.
b/. Source: https://www.coveredca.com/PDFs/2013_leg_report.pdf, p.28.

[6] There is no explanation given why the higher amount is to be available only in year 1 despite the proposal to phase-in the population over 4 years.

[7] Calculation is based on the following: 6.3 million (potential participants) X .25 (average percent of targeted persons included during the first four years) X 48.6 (average cost per targeted person in Covered California) X 0.333 (assumed relative cost per targeted person - Secure Choice versus Covered California).

A strong case can be made that the state should cover these costs: it is a state mandated program, with a broad policy goal that affects not only those who elect to participate, but those who decline to do so. In fact, SB1234 seems to contemplate some up-front state investment before the Secure choice program becomes “self-sustaining” (meaning that all its costs are covered from participants' deposits and investment earnings). Therefore one option would be to seek a General Fund Appropriation to cover the costs of public outreach and communication for all or most of the four-year phase-in period.

On the other hand, if the decision is to fund these costs from program revenues, they should be included in the feasibility analysis. We show how that would impact the sustainability of the program below.

EDD enforcement. SB 1234 gives the EDD “the power and duties necessary to administer the enforcement of employer compliance with” Secure Choice. The EDD would be authorized to bill the Board for its enforcement costs. With nearly 300,000 targeted employers in the state, the costs of enforcement would likely be significant. For comparison, Covered California operates a program of outreach to small businesses that costs $16.9 million per year. The Overture report acknowledges enforcement costs but does not include funds to cover them.

Retirement investments clearinghouse and vendor registration. SB1234 requires the Board to establish both a Vendor Registration and Investment Clearinghouse on the EDD website. The Act requires that the costs of developing and maintaining the Clearinghouse and Vendor Registration sites and processes be covered by the participating investment firms. Currently, most private sector retirement plans are provided by significant workforces of agents who can explain options to employers and participating employees. If the clearinghouse is intended to fill the role that is currently filled by agents, it will need to be well staffed and adequately budgeted. The Overture report does not explicitly budget for these costs, which would have to be covered under the administrative allocations from assets of the program.

Overture's Estimates of Income Replacement

Workers contemplating whether to participate in Secure Choice will weigh the loss in current income against the expected replacement income they will receive upon retirement. Overture notes in its report that “(t)here is no consensus on how high the income replacement ratio must be to maintain the same standard of living during retirement as before retirement (but) various studies have suggested that middle class households should target income replacement ratios between 65% and 85%; while lower-income households typically need higher replacement ratios than middle-income households because they spend a larger proportion of their incomes on necessities.”

In its investment analysis, Overture models the effects of different strategies on a hypothetical worker who accumulates assets over a 42-year career, working and contributing 5 percent per year, every year, from age 25 to age 67. Under its preferred investment strategies, Overture estimates that the Secure Choice program will generate lifetime income replacement of about 24 percent of the worker's final-year wages.

While the main purpose of its analysis is to compare results of different investment strategies, Overture also uses a replacement rate in this range (22 percent for a worker retiring at age 65) to illustrate the potential benefits to a typical full-career worker. It combines these benefits with the estimated 37-percent income replacement that this worker would receive from Social Security to arrive at total retirement income equal to 59 percent of wages.

Significantly, the results show that even under idealized conditions, the income replacement ratio for this worker will be below the bottom of the suggested range for middle class families, which in turn is lower than the range considered adequate for lower-income households.

More important, however, is that the actual income replacement ratio for most workers participating in the Secure Choice program will likely be *considerably less* than the 22-percent to 24-percent range shown in the report for most workers participating in the program.

This is because the Overture estimate does not take into account the effects of employment separation, financial emergencies, and other "real life" factors that are likely to affect savings levels under the program. It also does not show the reduced benefits that will accrue to workers who are not covered for a full 42 years under the program - either those who are mid-career when the program commences or those who retire before age 67 because of health or family reasons, or late-career layoff.

Impacts of Real World Factors on Income Replacement

To show the impacts of less-than idealized conditions on the Overture estimates, we replicated its estimates for a typical employee's wages, inflation, investment returns and other factors over a 42-year career.[8] We then used the same model to evaluate the impact of periods of unemployment, cash-outs, reduced contribution rates, early retirement, investments in low-risk funds, and shorter coverage periods.   The results of our analysis are shown in Table 2 and described in detail below.

[8] The estimates are based on a 25 year old employee who earns $30,000 per year (with annual increases of 3 percent per year), and contributes 5 percent of his annual salary each year until age 67. The accumulated assets are then converted to a group lifetime annuity that has a 15-year certain period and 2-percent annual escalation. The full set of assumptions are shown on pages 74 and 75 of the Overture Report.

Table 2
Income Replacement Generated By Secure Plus *a/*

	Percent of Final-Year Income Replaced	
	5-Percent Annual Contribution	**3-Percent Annual Contribution**
Overture's Example (42 years of continuous contributions).	24.6%	15.3%
Impact of Real World Issues		
Employment breaks of about 20 percent, no cash-outs *b/*	19.5%	11.7%
Employment breaks with 2 cash outs. *b/,c/*	14.9%	8.9%
Early Retirement (age 62)	17.2%	10.3%
Stable fund portfolio (2.5 percent return)	9.7%	5.9%
Impact of Fewer Years of Coverage		
30 Years	13.8%	8.3%
20 Years	7.6%	4.6%
10 Years	3.3%	2.0%

a\ Assumes portfolio balance at retirement is converted to a group annuity with 2% annual escalation.
b\ Consistent with average period of separation from the workforce shown in BLS panel study of workers from 1979 through 2013. Assumes a 2-year break at age 29, and 1-year breaks at 33, 35,40,50, 60, and 65.
c\ Same as previous scenario but in addition, participant is assumed to cash out 25 percent of the accumulated account balances at ages 30 and 40.
d\ Participant is assumed to take retirement at age 62 and make conversion of accumulated assets to a group annuity.

Overture full-career estimate. Using the assumption shown in the Overture report, we estimate that a worker contributing 5 percent of annual income would accumulate enough assets over a 42-year career to replace 24.6 percent of final year wages at retirement. In today's dollars that would equal about $750 per month.

Impact of a reduced contribution rate on basic estimate. In the section of it's report discussing the results of the focus group sessions, Overture reports that many participants indicated that they would be able to contribute *less than* $100 per month to their accounts (for an employee earning $30,000 per year $100 would represent 4-percent of monthly income). Worker and consumer organizations expressed similar concerns about the ability of workers to sustain 3- to 5 percent contribution rates given financial pressures on low-income workers. This is not surprising given the high cost-of-living households face in California, particularly in the coastal regions where rents have soared to unprecedented levels. It is also worth noting that a clear majority of other states that have passed similar legislation are currently specifying default contribution rates of 3 percent. Table 2 therefore displays the results for a 3-percent contribution rate. It shows that the income replacement ratio would fall to 15.3 percent ($468 per month in today's dollars) for a full-career employee.

Employment breaks with no hardship withdrawals. A key reason why the idealized estimate included in the Overture report overstates likely income replacement for most workers is because it fails to account for periods of unemployment or labor force separation that normally occur during a typical worker's lifetime. The Bureau of Labor Statistics' most recent longitudinal survey on work and non-work experiences of baby-boomers from 1979 through 2013 found that a typical person covered by the survey was separated from employment about 22 percent of the time between ages 18 and 48.[9] For workers age 25 and over, the average time was just under 20 percent. The rate was higher for those with less than a high-school degree (40 percent) or only a high-school degree (23 percent), than for those with a bachelors degree or higher (16 percent). This is significant because workers eligible for the Secure Choice program tend to have lower incomes and levels of educational attainment.

To approximate the effect of unemployment on accumulated savings at retirement, we assumed that our hypothetical worker is separated from employment for 8 out of the 42 years. As shown in Table 2, if this worker skips annual contributions during the years of employment separation - but never cashes out any of the funds in the account - the income replacement ratio would fall from 24.6 percent to 19.5 percent ($599 per month) assuming a 5-percent annual contribution rate. The replacement ratio falls to 11.2 percent ($360 per month) under the assumption of 3-percent annual contributions.

Employment breaks with hardship withdrawals. If this worker is forced to make hardship withdrawals during one or more of periods of employment separation, the replacement ratio falls further. The example in Table 2 shows the effects of two hardship withdrawals equal to 25 percent of the assets in the worker's account. The first is assumed to occur at age 30 and is for $3,690. The second occurs at age 40 and is for $6,225. The combination of missed contributions and the two withdrawals would lower the replacement ratio to 14.9 percent assuming 5-percent annual contributions, and 8.9 percent assuming 3-percent annual contributions.

Early retirement. Overture's replacement ratio estimate assumes the worker retires at age 67. While this is only slightly older than the current Social Security full retirement age, it is over 4 years beyond the average retirement age for all Americans in 2013, which was slightly under age 63.[10] While some early retirements are voluntary, many

[9] Based on the Bureau of Labor Statistics national *Longitudinal Survey of Youth 1979*, which is a survey of 9,964 men and women who were ages 14 to 22 when first interviewed in 1979 and ages 47 to 56 when interviewed most recently in 2012-13. See "BLS New Release (USDL-15-0528), Number of Jobs Held, Labor Market Activity, and Earnings Growth Among the Youngest Baby Boomers: Results From a Longitudinal Survey." March 31, 2015. http://www.bls.gov/news.release/pdf/nlsoy.pdf

[10] Source: Alicia H. Munnell, "The Average Retirement Age - an Update." *Center for Retirement Research at Boston College*. March 2015, Number 15-4.

are because of family or health reasons, or because of late-career layoffs and extended unemployment.

Workers forced to retire before age 67 would face reductions in wage replacement for two reasons. First, because of fewer contribution years and less investment returns, they would have less assets in their retirement accounts. Second, the reduced level of assets, when converted to an annuity, would have to cover a longer retirement period - hence a further reduction in annual annuity payments.

As shown in Table 2 retirement at age 62 would reduce the replacement ratio to 17.2 percent of final year's wages. In today's dollars, the monthly payment would be reduced from $756 for retirement at age 67 to $515 for retirement at age 62. Under the 3-percent contribution scenario, the income replacement ratio would fall to 10.3 percent ($309 per month).

Using stable value funds to avoid reductions in account values. One of the key provisions of SB 1234 is that individual accounts be protected at all times and that the state be held harmless against liability in connection with funding retirements benefits under the program. As noted previously, we are not aware of insurance products that would fully indemnify the state, but one way to minimize risk would be to limit investments to short-term financial securities, such as U.S. Treasury bills and high-grade corporate bonds. Such an investment strategy would, of course, come at a cost in terms of yield, as rates on high-quality, short-term securities are currently much lower than 2 percent. As shown in Table 2, assuming investment returns for a low-risk portfolio that is equal to inflation (2.5 percent) would reduce the expected replacement ratio for the 42-year employee with constant 5-percent contributions from 24.6 percent to just 9.7 percent. Assuming 3-percent annual contributions, the replacement ratio would fall to 5.9 percent.

Shorter coverage periods. Finally, over one-half of the eligible workforce today is over 35 years, and thus will have remaining working careers that are considerably less than the 42 years assumed in Overture's estimates.[11] These workers would have less time to accumulate assets under the Secure Choice program, and thus would have less income replacement at full retirement. Specifically, the bottom panel of Table 2 shows that under the 5-percent contribution scenario, income replacement would range from 3.3 percent ($86 per month) for someone who is age 57 at the time of the program's inception, and thus has only 10 years in the program, to 13.8 percent for someone who is age 37 when the program starts, and thus has 30 years in the program. Assuming annual contributions of 3 percent, the range is from 2.0 percent for someone who is age 57 to 8.3 percent for someone who is age 37 at the time of the program's inception.

Conclusion. The 22- to 24 percent income replacement ratio shown in the Overture report is a worthy goal, but is not a realistic expectation for the majority of participants in

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[11] Source: Figure C-2 (page 29) of Overture's final report to the California Secure Choice Retirement Savings Investment Board.

the Secure Choice program due to the varied financial pressures, job separations, and other real-world issues the participants will likely face over their careers. The likelihood that the replacement ratio will be lower is not meant to be an indictment of the program. Indeed any improvement in retirement savings would be a welcome development. However, before implementing a new mandate, it is important that its realistic benefits, as well as costs, be fully understood. Our analysis of real-world scenarios demonstrates that, for many participants in the Secure Choice program, the benefits will be limited, in some cases to a few hundred dollars per month or less.

Financial Feasibility Study

A key component of the Overture report is its analysis of the financial feasibility of the Secure Choice Program. For this analysis, Overture developed a financial projection model to determine whether the costs associated with implementing and running the California Secure Choice program were within acceptable limits over time, i.e., less than 1 percent of invested assets each year. This cap is consistent with SB 1234. It also reflects the fact that administrative costs in excess of 1 percent will significantly reduce participants' investment returns and retirement savings, and will make the program unattractive.[12]

Overture's key conclusions. Based on its financial modeling, Overture concludes "the program is financially viable and self-sustaining even under adverse conditions, with poor investment returns and high opt-out rates." Under its baseline scenario, program costs exceed the 1-percent threshold in each of the the first 4 years, but then fall well below 1 percent in subsequent years as assets in the fund grow. They indicate that financing the overages in the early years would require issuance of debt totaling $89 million, which would be paid back with interest from surplus funds by year 6. Under more pessimistic scenarios regarding contribution levels, opt-out rates and investment returns, Overture shows financing costs as high as $170 million, and the payback taking as long as 10 years. However, in all scenarios it modeled, Overture asserts that the program is viable on a long-term basis.

CMC review of overture's assumptions. Based on our analysis, we believe that the basic methodological approach and many of the assumptions used by Overture are reasonable. However, as noted earlier, it has not included funding for outreach education, enforcement and call centers that is adequate for successful implementation of the program. Furthermore, the level of record-keeping costs - a key driver of overall expenses - is well below industry averages for existing 401(k) plans.

Outreach, education, call centers, and enforcement. As already noted, the feasibility study does not include key costs for employer/employee outreach, education, call centers and enforcement, which we believe will be crucial to the successful implementation of the program. As we explain above, these costs likely will average $25

[12] We note that the other states considering legislation similar to SB 1234 have imposed lower administrative caps. For example, legislation in Connecticut provides for a cap of 0.75 percent.

million per year or more during the phase-in period, and smaller, though still significant amounts in subsequent years. A key decision for policymakers is whether to cover these costs with a General Fund appropriation, or to "internalize" them by charging higher administration fees, as shown in Table 3.

Record keeping expenses. Record keeping expenses are a key factor in the Overture model. In fact, on page 91 of its report, Overture identifies the administrative portion of the Secure Choice program as the largest cost item and biggest determinant of the program's financial feasibility. The Overture modeling assumes that annual costs for record keeping, trust services, and custodial services will be about $32 per participant during the first 5 years of the program. This is about one-half the median rate charged in private sector defined contribution plans in 2015.[13]

Overture representatives indicate that their estimates are based on cost drivers developed by Bridgepoint, a provider of consulting services to numerous large record keeping companies, along with the detailed workflows associated with the record keeping duties under the Secure choice program. We were told that the specific benchmarks used to develop these estimates are proprietary, because they are based on confidential company information on costs.

Generally, Overture indicates that the unit cost drivers they are using reflect a pared down level of record keeping services. For example, they envision requiring use of ACH transfers instead of checks for transferring funds, encouraging use of online services, and limiting paper account statements to once per year.

Because of the lack of specific information on the factors underlying its unit cost estimates, it is not possible for us to directly evaluate them. We can say, however, that they appear to be low relative to reported industry averages - even after making allowances for the pared down level of services envisioned by Overture. Our key concern is that the record keeper selected for the Secure Choice program will experience enormous challenges not normally faced by record keepers for traditional employer-sponsored plans. For example, it will be dealing with over 125,000 businesses with 10 or less employees, many of which lack sophisticated payroll systems or basic familiarity with employee retirement benefits. We would expect many of these firms to be uploading payroll data through a data portal or excel spreadsheet templates. These factors will translate into additional time and staffing demands on the record keeper for addressing problems that will inevitably emerge, particularly, during the phase in period. In addition, the record keeper will be dealing with a diverse population, requiring communications in multiple languages, and often-limited degrees of financial literacy.

Another factor is that, as noted in the Overture report, many of the participants will be part time, seasonal workers, often with limited resources. This will likely translate into

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[13] Source: "NEPC 2015 Defined Contribution Plan & Fee Survey: What a Difference a Decade Makes." Ross Bremen, CFA, Partner.

high costs for relating to both tracking employee accounts, processing cash outs, and frequent contribution changes. The record keeper could mitigate some of these costs by placing limits on changes, or by charging user fees for these types services, but such charges would make the program less attractive to potential participants.

Given these factors, and the importance of record keeping costs to the overall feasibility of the program, we believe that the Board should carefully consider the risks associated with higher-record keeping costs prior to implementing the program.

Impact of Additional Costs On Financial Feasibility of the Secure Choice Program

In this section, we model the effects of both (1) the additional outreach related costs (if paid from program administrative fees) and (2) higher costs for record keeping on Overture's conclusions regarding the feasibility of the Secure Choice program. Table 3 displays the results of our simulations.

The first row summarizes Overture's key conclusions about the costs of the program under its baseline assumptions. It shows that first year costs would represent 3.17 percent of assets, but the cost ratio would fall to 0.76 percent in year 5 and to 0.45 percent in year 10. It also shows that Board would need to borrow $89 million to hold administration expenses charged to participants to less than 1 percent in the early years of the program, and that the program would generate sufficient assets to repay the loan by the 6th year following program implementation.

CMC findings. Based on our modeling of additional costs needed for outreach, education, enforcement, a call center, and record keeping, we conclude that if some or all of these expenses were paid for from the program's assets, the outcomes under various scenarios would be significantly *less favorable* than shown in the Overture report. Specifically:

- **Additional costs for outreach and related activities.** If we assume that the state spends $25 million[14] annually in years 1 through 4 and $15 million annually thereafter for outreach, education, and a call center, annual expenses as a percent of assets would jump to 4.75 percent in the first year of the program, to 0.83 percent in year 5, and to 0.48 percent in year 10. The additional expenses would boost the amount of borrowing needed to offset the excess administrative costs (those above 1 percent of assets) to $170 million, and the number of years needed to pay off the loan would increase from 6 to 7.

[14] The $25 million reflects potential funding for outreach, eduction, and call centers - discussed above in the section titled " Significant Fiscal Issues Not Addressed in the Overture Report." It does not include potential costs for enforcement, which could be funded from some combination of penalties, General Fund appropriations, or program assets.

- **Additional costs for record-keeping.** If record-keeping costs come in near the 401 (k) industry average, annual expenses as a percentage of asset would be 4.47 percent in year 1, 1.24 percent in year 5, and 0.67 percent in year 10. The required financing would jump to $368 million, and the payoff of the loan would not occur until year 10.
- **Combined effect.** If both the above-two increases occur, annual expenses as a percentage of assets would increase to 6.08 percent in year 1, 1.32 percent in year 5, and 0.70 percent in year 10. The required financing would increase further to $466 million, and the loan payoff would not occur until year 11.

Finally, when the additional costs are included, the Secure Choice program becomes more vulnerable to adverse outcomes related to other factors modeled by Overture in their sensitivity analyses. As shown in the bottom row of Table 3, if (1) the added costs for outreach and record keeping expanses are included, (2) the contribution rate falls to 3 percent and (3) the opt-out rate rises modestly to 33 percent, program administration costs would jump to 9.61 percent of assets in year 1, and would not fall below the 1 percent cap until year 10. The loan needed to cover these overages would jump to $644 million, and payoff of the loan would not occur until more than 15 years after the start of the program.

Table 3
Impact of Added Costs On Financial Viability The Secure Choice Program

	Program Costs as a Percent of Assets In:				
	Year 1	**Year 5**	**Year 10**	**Financing Cost (Millions)**	**Payoff Year**
Overture Baseline	3.17%	0.76%	0.45%	$89	6
Additional Funding:					
Public Outreach, Communication, Enforcement	4.75%	0.83%	0.48%	$170	7
Record keeping ($64 per participant)	4.47%	1.24%	0.67%	$368	10
Combined Effect	6.08%	1.32%	0.70%	$465	11
Combined, Conservative	9.61%	1.97%	0.99%	$644	>15

Bottom line regarding Overture's financial projections. Overture's conclusion that the Secure Choice is viable even under adverse conditions with high opt-out rates only holds if (1) costs for outreach, education, enforcement and call centers are provided from state funds or other non-program sources and (2) record keeping costs come in well below industry averages - an event we consider unlikely.

Even under Overture's baseline assumptions the added expenses we have highlighted would raise fees charged to participants, thereby reducing their investment returns and rate of asset accumulation over time. Equally important, the additional costs would make the program highly vulnerable to adverse results, such as lower contribution rates or higher opt out rates by prospective participants.

Summary

Our review indicates that the Board will need to address several issues not included in the Overture report, including whether or not to recommend repeal of the insurance/annuity/indemnification requirements in statute (GC Section 100013) and how to budget for outreach, enforcement and a clearinghouse for employers and participants. In addition, our review of the major fiscal issues addressed in the Overture report finds that (1) the replacement income (retirement income) that many participants should expect will be substantially less than the best-case scenario presented in the report - for some less than $100 per year - and (2) the report significantly understates the administrative costs likely needed to ensure the program is implemented successfully.

Funding these costs from program assets raises administrative expenses charged to program participants, thereby reducing their investment returns and accumulation of retirement assets. The additional costs also make the program more vulnerable to adverse developments, such as lower-than- expected participation or contribution rates. For these reasons, the financial projections, and particularly the impacts of the additional cost pressures on the financial projections, should be carefully evaluated by the Board.

Sincerely,

Brad Williams
Chief Economist
Capitol Matrix Consulting

Michael Genest
Founder and Chairman
Capitol Matrix Consulting

Center for Economic and Policy Research
1611 Connecticut Ave., NW
Washington, DC 20009
202-293-5380, 114
February 23, 2016

Treasurer John Chiang, Chair California Secure Choice Retirement Savings Investment Board
915 Capitol Mall, Room 110
Sacramento, CA 95814

Dear Mr. Chiang:

I am writing in reference to the decision facing the Secure Choice Board on the investment plan to recommend to the legislature. I would argue strongly in favor of the pooled funding option. I make this judgement based on my research and participation in policy debates on retirement security over the last quarter century.

There are two reasons for preferring the pooled funding option. First and most important, the alternative, individual target date funds, does not protect workers from timing risk. While target date funds reduce a worker's exposure to the stock market as they approach their expected date of retirement, they are still likely to have 50 percent or more of their portfolio in the stock market in the last years before they retire.[1] This leaves them vulnerable to the sort of market downturn that we saw in both 2000-2002 and 2008-2009, both instances in which the main market indices lost more than half of their value.

Such downturns are presumably rare, but obviously not impossible. One of the biggest benefits that the State of California can provide to its workers through the Secure Choice program is protection against this risk. For most workers, losing 25 percent of their retirement savings as a result of a market downturn will mean a much less comfortable retirement. Since the pooled funding option provides a mechanism that will remove this risk at no cost to the taxpayers, it seems foolish not to take advantage of this possibility.

The other factor is simply that the pooled funding option will in the long-term allow workers to receive a substantially higher rate of return on their savings. I recognize that the study shows that these higher rates of return only accrue to later cohorts, with the first group of participants roughly breaking even with investments in target date funds, but if a long-term gain can be had at essentially no short-term

[1] This risk is made greater by the fact that nearly 40 percent of workers retire earlier than planned, which means they may find themselves more exposed to the market than would be desirable at the point of their retirement (See Munnell, A., G. Sanzenbacher, and M. Rutledge, 2015. "What Causes Workers to Retire Before They Plan," Center for Retirement Research at Boston College, available at http://crr.bc.edu/working-papers/what-causes-workers-to-retire-before-they-plan/).

cost, it seems wasteful to forego the opportunity.[2] The study concluded that the pooled investment option would increase workers' retirement income by 10-20 percent compared with the target date fund option. This means that a worker who puts $2,000 a year into the pooled investment fund would get the same retirement income as a worker who put $2,200 to $2,400 annually into target date funds.

While I recognize the concern that the pooled investment option has some additional complications in management, the issues that arise should pose little difficult for competent actuaries.[3] There is also an issue that the pooled investment option may seem more complex to many participants. This is a risk, but surveys have consistently shown that workers are already quite confused about the nature of the investment options facing them. For this reason, it is likely that many will not understand the notion of a "target date fund" either. The issue is not comparing a fully transparent system with one that may seem somewhat opaque; it is comparing two systems, one of which may be marginally more complex than the other.

Even though I view it as important that workers be as well-informed as possible about their retirement system and what is being done with their money, whatever marginal confusion results from the pooled investment option seems a small price to pay for the elimination of timing risk and the increase in returns available to later cohorts of participants. For these reasons, I hope that the Board will recommend the pooled investment option to the legislature.

Sincerely,

Dean Baker
Co-Director

Cc: Board members

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[2] In principle it would be possible for the State of California to lend money to build up initial reserves in the system, although this may not be feasible for political reasons.

[3] I have done analyses that project future stock returns based on the current ratio of prices to trend earnings. These suggest that a properly managed fund should face little risk meetings it return target (Rosnick, D. and D. Baker, 2012, "Pension Liabilities: Fear Tactics and Serious Policy," Washington, DC: Center for Economic and Policy Research, available at http://cepr.net/publications/reports/pension-liabilities-fear-tactics-and-serious-policy).

Office of the Treasurer & Tax Collector
City and County of San Francisco

José Cisneros, Treasurer

March 4, 2015

State Treasurer John Chiang and CA Secure Choice Board Members
915 Capitol Mall, Suite 110
Sacramento, CA 95814

RE: Comments on the Final Report to the Secure Choice Savings Investment Board

Dear Treasurer Chiang and fellow Secure Choice Board Members,

I would like to thank you for your work on behalf of the California Secure Choice Retirement Savings Program. Both in my role as San Francisco Treasurer and as founder of the San Francisco Office of Financial Empowerment, I know how important retirement savings are for our residents. I also know that we are dealing with a coming crisis of retirement insecurity in San Francisco and around our state.

As you are well aware, three out of ten California seniors do not have enough income to cover their basic needs. Seniors of color are much more likely to live in poverty in California, and as we look ahead to the retirement of the baby boomer generation, and to shifting demographics that will have people of color making up a majority of California's senior population by 2035, the issue of retirement security will only become more pressing. This is why it is so important that the Secure Choice Program provides access to a retirement savings plan for the 7.5 million working Californians who do not have access to a retirement plan through their employer.

I will keep my comments fairly brief, and overall I wish to commend the work that has been done by all of those responsible for guiding Secure Choice to this point, including Treasurer Chiang and his staff and the Secure Choice Board. I strongly support Secure Choice, and look forward to legislation that will implement this Program soon. On behalf of my Office of Financial Empowerment (OFE), I would like to offer comments that deal with: 1) program simplicity and setting defaults for broad or even universal participation; 2) ensuring low plan costs and avoiding expenses that would eat into savings for participants; and 3) working with municipalities and municipal agencies as part of the Program's outreach and education strategies.

First, I commend the simple program design envisioned by Secure Choice. In order to make this program workable for employers and to ensure broad participation, I strongly support the elimination of barriers to entry. This includes emphasizing an opt-out rather than opt-in for employees, reducing or eliminating the need for signatures or other forms, and ensuring that employers do not bear a heavy administrative burden to participate and enroll their employees. I largely concur with the recommendations of the Report in this regard, and urge that the final Program design maintains this simple and universal/automatic enrollment structure.

I also believe that the Report does a good job in identifying the Roth IRA investment vehicle that is most efficient and beneficial for California workers. In the experience of the OFE in its work around savings and guiding consumers toward safe and affordable financial products and services, it is important to reduce complexity and guide people through a very small set of choices, again with a goal of eliminating barriers to entry and participation. This aligns with a Secure Choice design that minimizes investment choices (for example by offering only conservative, moderate, or higher-risk options). I also support the recommendation to set a 5% default rate, and to auto-escalate the savings rate up to 10% (with an opt-out), although I do urge further study of affordability at this higher rate for low-income employees who may be living paycheck to paycheck.

I do urge the Board to look very carefully at any proposed management fees associated with the final investment vehicle(s). For this Program it will be important to keep these fees as low as possible so that residents may maximize their savings. It would seem prudent, therefore, to select lower-cost investment options, such as target date index funds, and to be wary of higher-cost options such as variable annuities. I am sure that most Californians will share this recommendation to minimize the fee burden for participating – and often low-income – employees.

Lastly, I am glad to see that the Report does emphasize not only the need for outreach, but the low levels of financial literacy that can make it more difficult to educate targeted employees about the Secure Choice. I note that partnership with city and county governments was not one of the outreach strategies recommended within the Report, and I encourage the Board to strongly consider municipal partnerships. Cities, and city agencies, are on the ground working with employers and employees directly, and have strong local knowledge that can make outreach more effective.

Further, many municipal agencies are very much focused on helping residents achieve financial success, including retirement security. Here in San Francisco, our Office of Financial Empowerment has developed and implemented a range of programs and resources to support financial wellbeing for our residents. The OFE has established employer engagement strategies and partnerships which offer a great platform for Secured Choice outreach. We also are delivering one-on-one financial coaching in the workplace, and can help to address the issues of financial literacy raised in the Report, to help employees better understand their retirement savings options and the benefits of Secure Choice participation.

We would be glad to discuss this further with members of the Board, and hope that you may consider the need for municipal funding for financial education and outreach. Again, thank you for your leadership and your commitment to such an important issue in California. I would be pleased to continue this discussion and answer any questions you may have.

Sincerely,

José Cisneros

My name is Dolores Manning. I am a resident of Santa Cruz County and retired from Santa Cruz County government employment. I am here to ask the Board to choose the option for investment of the retirement savings funds that will provide the most stable and dependable returns for workers.

I would like to tell you briefly about the experiences of my family that motivated me to come to this hearing. I have a CalPers pension that I can depend on, but my 3 aging children, in their fifties, are not that fortunate. They all started saving for retirement early and saved well, but the recession has derailed their plans.

One son bought a house shortly before the recession. To keep the loan interest down he used retirement savings for a large down payment and planned to sell the house, downsize and recoup his retirement savings as soon as his family left. Then the recession forced many of the houses in his neighborhood into foreclosure. The houses were resold at a fraction of their original cost to people who rarely had the money to keep them up. The market value of houses in my son's neighborhood has remained very low. After all this time he still owes more on his house than its' market value. He hopes to eventually sell for what he owes, but he says he doesn't anticipate that he will ever get back any of the hundreds of thousands of dollars he paid down.

My daughter has a 401(k) and she also had substantial other savings invested for her retirement. She lost her job in the recession and had to live for two years on the then devalued investments where she had placed her savings. She was at the point of having to cash in her 401(k) as well and take penalties and losses on it when she was offered a job in a small rural town in Florida. Her pay on this job is less than half of her previous salary. She has barely enough income to live on paycheck to paycheck and isn't able to save anything to replace her retirement savings.

I feel that the experience of my family is a strong argument for the pooled option, which would tend to protect workers' savings from large market swings that they can't predict. I urge you to choose the less risky pooled option.

Thank you.

Economic Policy Institute
1333 H Street NW Suite 300
Washington DC 20009

February 25, 20009

Treasurer John Chiang
Chair
California Secure Choice Retirement Savings Investment Board
915 Capitol Mall, Room 110
Sacramento, CA 95814

Dear Treasurer Chiang,

I commend the board and the authors for a thoughtful report on design options for the California Secure Choice plan.

I am writing in support of recommended investment option 2, the pooled IRA with reserve fund. In the long run, this option will provide greater retirement income to participants yet better protect them from damaging losses than recommended option 1 (target date funds).

The Economic Policy Institute's Guaranteed Retirement Account plan had an early model of a reserve fund used to smooth investment risk across retiree cohorts (Ghilarducci 2008) (http://www.epi.org/publication/bp204/). I also discussed the advantages of a reserve fund in my response to the California Secure Choice Retirement Savings Program RFI (http://www.treasurer.ca.gov/scib/rfi/epi.pdf).

Target date funds, though an established investment vehicle, are poorly understood by participants and even many financial advisors, who believe them to be less risky than they are. In the popular understanding, target date fund investors achieve high returns early in their careers by investing mostly in equities, then lock in these gains by increasing the fixed-income share of their portfolios as they approach retirement.

In fact, participants in target date funds are as likely to lock in low early returns as high ones. That is, a portfolio that gradually shifts from a 75/25 stock-bond allocation to a 35/65 allocation—similar to the "lower-risk" target date fund in the report—is no less risky than one with a fixed 55/45 allocation. And due to volatility drag, a target date fund will achieve a slightly lower return on average than a similarly risky portfolio with fixed asset class shares.

As I noted in my response to the RFI, the only real advantage to target date funds is that younger workers are better able to adjust their contributions or retirement expectations in response to investment returns. The advantage is not, as is commonly believed, that investing in stocks early in a career is less risky because cumulative returns average out over time (they do not).

This advantage of target date funds—that younger workers have more time to adjust their savings and retirement plans—must be weighed against the false sense of security these funds engender. Participants are likely to underestimate the risk of late-career losses even for the “lower-risk” target date fund presented in the report, let alone for the “typical” target date fund with a glidepath going from 90 percent stocks to 50 percent stocks. The problem of overconfidence in bull markets—and panic selling in bear markets—is not a hypothetical one, as the baby boomers learned to their dismay.

While the pooled IRA with reserve fund option would not eliminate investment risks (nor counterproductive responses to these risks), it would help smooth retirement outcomes while protecting workers against late-career losses. Thus, participants would be able to take advantage of higher expected returns on moderately risky portfolios while being shielded from the worst outcomes, such as those experienced by baby boomers approaching retirement during the recent financial crisis and ensuing Great Recession.

Importantly, the reserve fund would shield participants against losses at no cost to participants as a group, in contrast to strategies that rely on purchasing guarantees or investing very conservatively. The board may want to explore whether additional risk smoothing could be achieved by narrowing the collar or other changes, but regardless the reserve fund restores some of the risk pooling lost in the shift from a pension to an individual savings model of retirement.

Sincerely,

Monique Morrissey
Economist

FINANCIAL SERVICES INSTITUTE

VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS
AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

March 3, 2016

Ms. Christina Elliott
Acting Executive Director
California Secure Choice Retirement Savings Investment Board
Post Office Box 942809
Sacramento, CA 94209-0001

RE: Market Analysis, Program Design, and Financial Feasibility Study of the California Secure Choice Retirement Savings Program

Dear Acting Executive Director Elliott:

The Financial Services Institute (FSI)[1] appreciates the opportunity to comment on Overture Financial, LLC's report to the California Secure Choice Retirement Savings Investment Board (Board) on the California Secure Choice Retirement Savings Program. On behalf of FSI's 100 independent broker-dealer member firms doing business in California (including 12 California-based firms) and over 3,400 financial advisor members who reside in state we applaud California for its proactive interest in increasing retirement security for its residents and its desire to expand access to retirement savings products by private sector employees. While FSI shares this goal, we believe that the state and its private sector workers would be better served by leveraging the private savings options currently available rather than taking on the risks and limitations associated with a state-run plan.

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the U.S., there are approximately 167,000 independent financial advisors, which account for approximately 64.5% percent of all producing registered representatives. These financial advisors are self-employed independent contractors, rather than employees of independent broker-dealers.

FSI member firms provide business support to financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners who typically have strong ties to their communities and know their clients personally. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations and retirement plans with financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide Californians with the financial advice, products, and services necessary to achieve their investment goals.

[1] The Financial Services Institute (FSI) is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has successfully promoted a more responsible regulatory environment for more than 100 independent financial services firm members and their 160,000+ affiliated financial advisors – which comprise over 60% of all producing registered representatives. We effect change through involvement in FINRA governance as well as constructive engagement in the regulatory and legislative processes, working to create a healthier regulatory environment for our members so they can provide affordable, objective advice to hard-working Main Street Americans. For more information, please visit financialservices.org.

In response to Overture Financial, LLC's report to the Board, we raise the following issues for your consideration as you make recommendations to the legislature:

State Liability
In sponsoring a state-run plan for private employees, California could assume significant liability and potentially become a fiduciary for the 6.8 million eligible participants. Additionally, Overture's report states that a no action letter from the SEC may be necessary, underscoring these concerns[2].

Alternative Plans
Offering a marketplace style plan would allow participants to choose from the robust private sector offerings that already exist, avoid state liability, and remove some of the barriers created by a secure choice style plan. For example, the report's recommended Roth IRA would not allow for voluntary employer contributions or matching. We are confident that designing a plan with broader investment options, such as those offered by FSI member advisors, would allow participants to better achieve the ultimate goal of saving more for retirement.

Cost to Small Businesses
FSI shares the concerns cited in the report regarding the administrative, education and cost burdens mandatory employer participation could place on small businesses[3]. Further, the employer's obligation to collect contributions via payroll deduction could trigger ERISA which would be another state and employer liability concern.

Promoting Financial Literacy
The state and its private sector workers would be well served by increasing financial and retirement literacy education and FSI members are always willing to serve as a resource for such programming.

Again, we thank you again for your consideration and we hope that we can serve as a resource to the Board and the legislature as you work to increase retirement savings options for all Californians.

Respectfully submitted,

David T. Bellaire, Esq.
Executive Vice President & General Counsel

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[2] See Overture Financial, LLC California Secure Choice Market Analysis, Feasibility Study, and Program Design Consultant Services, 17
[3] See Overture Financial, LLC California Secure Choice Market Analysis, Feasibility Study, and Program Design Consultant Services, 49

GEORGETOWN UNIVERSITY
McCourt School *of* Public Policy

March 11, 2016

The Honorable John Chiang, Chair
California Secure Choice Retirement Savings Investment Board
915 Capitol Mall, Room 110
Sacramento, California 95814

Subject: California Secure Choice Market Analysis, Feasibility Study, and Program Design: Final Report ("Final Report") to the Secure Choice Retirement Savings Investment Board ("California Board")

Dear Treasurer Chiang:

Thank you for your leadership in developing a retirement security program for California workers who currently do not have access to a retirement savings plan. California's work serves as a model for other states and builds a strong foundation for both current and future efforts to address the retirement security crisis, especially among uncovered workers.

The Georgetown University Center for Retirement Initiatives was established to develop and promote the bipartisan adoption of innovative models, utilizing pooled and professionally managed funds, to expand the accessibility and effectiveness of retirement solutions. The Center strives to serve as a leading resource to states considering legislation to create state-sponsored retirement savings plans for private sector workers who do not have access to a plan at work.

As you know, approximately one-half of private sector workers have no access to a retirement plan at work and few find ways to save for retirement on their own if a plan is not offered by an employer. As a result, almost one-half of working age households do not have any retirement assets, whether a defined benefit pension, work-sponsored 401(k) or even an IRA. Those who do have some retirement savings do not have nearly enough. The U.S. Government Accountability Office reported recently that among those with some retirement savings, the median balance for individuals aged 55-64 was $104,000, an amount that would create an annuity of about $310 a month.

We are encouraged by the momentum we see in states to address the retirement security crisis. As the California Board considers the recommendations from its Market Analysis, Feasibility Study and Program Design Report dated February 9, 2016, it is important to consider investment approaches and program structures that provide the best opportunity to strengthen retirement security for workers.

An ideal retirement program would ensure that workers build a retirement income that can last a lifetime and help keep them out of poverty. There are different, innovative ways to achieve this result, such as the pooled investment model with a reserve fund packaged as a retirement savings bond that the Board report recommends as one of the two recommended default investment options at launch. The Board report also recommends, as another investment option at launch, a form of low-cost target income strategy, which also could be implemented by a pooling of funds through a centralized administrative structure overseen by the California Board. There are innovative choices available to reduce risk and incorporate a retirement income focus in such approaches, ideally providing for maximum possible income replacement, which could be considered.

A key element common to these and other approaches considered can be the benefit of pooled and professionally managed capital – much like state or university pension funds/endowments, charitable trusts and other large investment vehicles - that has the ability to both create the fully diversified portfolios available to institutional investors – instead of the more limited investment options available to individually directed portfolios -- as well as to obtain the low operating and investment costs economies of scale can provide. Research suggests that pooled and professionally managed vehicles achieve higher rates of returns and lower costs – improvements in performance that can make a significant difference in the amount of savings for an individual over a 30-year time horizon.

Regardless of the investment mechanism ultimately selected by the Board, the ideal plan would include as many attributes of pensions as possible. In addition to pooled and professional management, the Board should recommend an approach that shares risk and provides for smoothing. The goal is to protect participants against negative market fluctuations, such as those who might have the misfortune of retiring during an economic downturn as we saw during the Great Recession in 2008.

We also applaud the Final Report for recommending that the California Board have discretion to consider other models for strengthening retirement security, namely whether or not the

California Board may want to consider a Multiple-Employer Plan (MEP) in the future to permit employer contributions that will allow for greater retirement security than IRAs.

Thank you to the California Secure Choice Retirement Savings Investment Board for its leadership on retirement security. The Georgetown Center for Retirement Initiatives looks forward to continuing to serve you as a resource in your efforts to build an accessible and effective program to strengthen the retirement security of millions of Californians today and for generations to come.

Sincerely,

Angela M. Antonelli
Executive Director
Center for Retirement Initiatives

cc: Ms. Christina Elliott, Acting Executive Director, California Secure Choice Retirement Savings Investment Board

INVESTMENT COMPANY INSTITUTE

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March 24, 2016

Delivered Electronically

The Honorable John Chiang
California State Treasurer
Chairman, California Secure Choice Retirement Savings Investment Board
915 Capitol Mall, Room 110
Sacramento, CA 95814

Re: Overture Financial Final Report to the California Secure Choice Retirement Savings Investment Board

Dear Treasurer Chiang:

The Investment Company Institute[1] appreciates the opportunity to provide comments on the Report (the "Report") prepared by Overture Financial LLC to the California Secure Choice Retirement Savings Investment Board (the "Board").[2] The Report reflects the market analysis, financial feasibility study, and program design recommendations of Overture Financial and its subcontractors with respect to the California Secure Choice Retirement Savings Program (the "Program"). The Program is contemplated as a state-run retirement savings plan for private-sector workers in California, pursuant to the California Secure Choice Retirement Savings Trust Act (SB 1234), enacted in 2012.

The Institute strongly supports efforts to promote retirement security for American workers. We understand and appreciate the interest shown by the state of California in ensuring that its residents have sufficient resources for retirement and share the goal of increasing workplace retirement plan access. Our member companies devote considerable effort to helping Americans prepare for and achieve a financially secure retirement. Due in part to the innovation that has taken place over the last few decades in the private sector, Americans currently have $24.0 trillion saved for retirement, with more than half of that amount in defined contribution ("DC") plans and individual retirement

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[1] The Investment Company Institute (ICI) is a leading global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's U.S. fund members manage total assets of $16.9 trillion and serve more than 90 million U.S. shareholders.

[2] The Report is dated March 17, 2016 and is available at www.treasurer.ca.gov/scib/report.pdf.

accounts ("IRAs").[3] About half of DC plan and IRA assets are invested in mutual funds, which makes the mutual fund industry especially attuned to the needs of retirement savers. The Institute has 36 member companies located in California with about 16,000 employees in the state and $3.5 trillion in assets under management. These California-based companies, as well as mutual fund companies based outside of California, provide investments and other services to retirement plans and individual retirement savers in California. Our members are eager to serve this marketplace with increasingly competitive product and service offerings.

We appreciate that the Board faces a significant challenge in making an informed, sound assessment of the Program. Unfortunately, the Report does not provide adequate support to meet that challenge. While the Report contains a great deal of survey data on the characteristics and views of workers without employer-provided retirement plan coverage, it fails to provide an adequate analysis of the financial feasibility of the Program. We are concerned that Program participants or California taxpayers—or most likely both—will find themselves bearing unanticipated costs as a result of the Program.

We urge the Board to conduct further analysis before moving forward with the Program. Many of the assumptions and conclusions in the Report, which are used to justify the Program's design, appear unrealistic or incomplete. This is the case even under the "pessimistic scenario" analyzed in the Report. Without additional information about the financial feasibility of the Program, we question how the Board can truly assess the Program, much less recommend it for further action by the California State Legislature.

The Program also raises important legal questions, as described in our November 15, 2013 letter to Mr. Grant Boyken responding to the California Secure Choice Retirement Savings Program Request for Information.[4] These legal questions—including the application of the Employee Retirement Income Security Act of 1974 ("ERISA") and federal securities laws—have yet to be sufficiently answered. In particular, SB 1234 requires that prior to implementation, the Board must find that the Program accounts will qualify for the favorable federal income tax treatment accorded to IRAs under the Internal Revenue Code, and that the Program is not an employee benefit plan under ERISA. As you know, the ERISA status of state-based programs is the subject of a pending rulemaking project at the U.S. Department of Labor ("DOL").[5] As the Report acknowledges, it is unclear whether

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[3] *See* Table 1 in Investment Company Institute, "The U.S. Retirement Market, Fourth Quarter 2015" (Mar. 2016); available at www.ici.org/info/ret_15_q4_data.xls.

[4] The letter is available at www.treasurer.ca.gov/scib/rfi/ici.pdf.

[5] DOL has proposed a regulatory safe harbor from coverage under ERISA for certain payroll-deduction IRA arrangements established and maintained by state governments. Savings Arrangements Established by States for Non-Governmental Employees, 80 Fed. Reg. 72006 (November 18, 2015). Under the safe harbor, these state arrangements would not be treated as employee benefit plans under ERISA, as long as specified conditions are met, including that state law requires certain employers to make the program available to employees. We do not believe that this proposal settles the ERISA status of any

certain investment structures would be permissible in a state-run retirement savings program and we understand that the Board may be seeking guidance from the Securities and Exchange Commission on those matters. These matters must be resolved before the Board considers recommending the Program.

More broadly, we are concerned that initiatives like that under consideration in California will ultimately lead to the creation of a fragmented, state-by-state system of retirement savings for private-sector workers.[6] A patchwork of state-run programs, each with its own unique rules, has the potential to harm the voluntary system for retirement savings that is helping millions of American private-sector workers achieve retirement security. In our view, the research and data suggest that these state initiatives are misplaced and that there are other more targeted changes at the national level that will be more effective at increasing access to payroll-deduction savings opportunities.[7]

We discuss our views of the Report below. First, we explain our concerns about the adequacy of the financial feasibility study in the Report, noting that the Report fails to adequately consider probable inaccuracies in the Report's assumptions that call into question the financial feasibility of the Program. The most significant of these are the Report's assumptions about opt-out rates, contribution rates, and withdrawal and turnover activity, which are all critical factors in the Report's conclusions. We also highlight the Report's failure to adequately account for all likely costs in implementing and operating the Program.

Second, we describe our broader concern about a fundamental assumption on which the perceived need for mandatory state-run retirement plans is based—that workers currently not covered

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particular state-run program, as it has not been finalized and, even if finalized in its current form, application of the safe harbor to any particular program would be a facts and circumstances determination that ultimately would rest in the hands of a court of law. As DOL noted, "the objective of the proposed safe harbor is to diminish the chances that, if the issue were ultimately litigated, the courts would conclude that state payroll deduction savings arrangements are preempted by ERISA." 80 Fed. Reg. 72009. DOL also notes that "courts' determinations would depend on the precise details of the statute at issue, *including whether that state's program successfully met the requirements of the safe harbor*." 80 Fed. Reg. 72011 (emphasis added).

[6] *See* letter from Investment Company Institute to U.S. Department of Labor, dated January 19, 2016; available at www.dol.gov/ebsa/pdf/1210-AB71-00062.pdf. Section 514 of the Employee Retirement Income Security Act of 1974 ("ERISA") provides that ERISA "shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan" covered by the statute. The intent of ERISA preemption is to avoid subjecting employers to a patchwork of different and likely conflicting requirements under potentially 50 state laws. With state laws such as SB 1234, employers that operate in multiple states or employ workers residing in more than one state will face significant burdens complying with differing requirements regarding covered employees, the type of retirement plan that will exempt an employer from the state's program, contribution rates, and automatic enrollment features, among others.

[7] For a description of such targeted changes, *see* letter from Investment Company Institute to U.S. Department of Labor, dated January 19, 2016; available at www.dol.gov/ebsa/pdf/1210-AB71-00062.pdf.

by employer-sponsored retirement plans will be best served by being automatically enrolled in such programs.

I. The Report Fails to Adequately Consider Probable Scenarios That Call into Question the Financial Feasibility of the Program

The Report concludes that "[t]he Secure Choice Program is financially viable and self-sustaining even under adverse conditions with poor investment returns and high "opt-outs" rates."[8] The Report rests this conclusion on a long list of assumptions, many of which are not likely to hold true. As a result, we fear that the Program is not nearly as financially secure and self-sustaining as it is portrayed to be. We recognize that attempting to model costs of any proposed initiative is a difficult and uncertain exercise, but we strongly caution that the Report does not appear to have fully considered many scenarios that are entirely possible, if not probable. Any combination of these alternative scenarios could result in much lower assets and much higher costs than suggested by the baseline scenario or the one-off changes studied. In addition, there appear to be costs that are not considered in the analysis even under the "pessimistic scenario" which specify a 10-year payoff period and $186 million funding gap.[9]

In this respect, there are several risks that could significantly affect the Program's asset growth and cost estimates. The most significant of these risks include the Report's assumptions about opt-out rates, contribution rates, and withdrawal activity and turnover, and the Report's failure to adequately account for all likely costs. We discuss each of these risks in more detail below. The Report also appears to rely on averages, which as a methodology does not recognize the range of workers and range of account balances and participation rates that may occur. This variability can have a material impact on the assets and costs of the Program.

A. The opt-out rate is a key risk to the **Program's** ability to build assets and manage costs

It is important for the Board to be aware that it is quite likely that automatic enrollment in the Program may not have results close to those produced by automatic enrollment in voluntary private-sector retirement plans. In this respect, the opt-out rate for the Program may be higher on average than is projected in the Report, or could be distributed across employers in a way that is more costly than projected. Plan design and workforce demographics affect opt-out rates and both are quite different between the private-sector retirement plans voluntarily implementing automatic enrollment and the proposed state-mandated Program to be applied to employers without plans.

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[8] *See* page 110 in the Report.

[9] *See* page 119 in the Report.

1. Plan design affects opt-out rates

The Report's baseline opt-out rate assumption for the Program likely is overly optimistic. Automatic enrollment may not be anywhere nearly as successful in increasing participation in California's Program as it is among employers who voluntarily adopt it for the plans that they offer their employees. First, automatic enrollment has been adopted more widely in the private sector by larger employers.[10] Such employers often combine automatic enrollment with other participation incentives such as employer contributions (which provide an immediate and positive incentive to save) and the availability of participant loans (which provides flexible access to the savings).[11]

The Board would be ill-advised to assume that participation and opt-out experience in the Program will be close to the private-sector experience, because it is difficult to disentangle the impact of one plan feature in isolation and some of the results achieved with automatic enrollment may also reflect the influence of other plan features. For example, BrightScope and ICI analyzed a sample of nearly 54,000 401(k) plans with 100 participants or more and at least $1 million in plan assets and found that 401(k) plans tend to have combinations of plan features.[12] The most common combination of plan features offered to workers includes employer contributions, which provides immediate growth in the 401(k) balance, and participant loans, which provides flexibility that in turn promotes larger contributions.[13] While the Program presumably would offer access to the accounts through withdrawals, which provides some flexibility, it would not provide employer or state contributions.[14]

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[10] *See* Utkus and Young, *How America Saves, 2015: A report on Vanguard 2014 defined contribution plan data*, Valley Forge, PA: The Vanguard Group (2015); available at https://institutional.vanguard.com/iam/pdf/HAS15.pdf.

[11] In the case of state-sponsored retirement plans that are IRAs, individuals could access the accounts through withdrawals. However, amounts withdrawn may be subject to penalties and/or income tax.

[12] Private-sector 401(k) plans with automatic enrollment are more likely to have both employer contributions and participant loans outstanding than plans without automatic enrollment. In 2013, 74 percent of 401(k) plans with automatic enrollment had employer contributions and outstanding participant loans. Nearly nine in 10 401(k) plans with automatic enrollment had employer contributions. *See* BrightScope and Investment Company Institute, *The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2013*, San Diego, CA: BrightScope and Washington, DC: Investment Company Institute (December 2015); available at www.ici.org/pdf/ppr_15_dcplan_profile_401k.pdf.

[13] *Id. See also* Beshears, Choi, Laibson, and Madrian, "The Impact of 401(k) Loans on Saving," *NBER Retirement Research Center Paper*, no. NB 09-05, Cambridge, MA: National Bureau of Economic Research (September 2010); available at www.nber.org/aging/rrc/papers/orrc09-05.pdf.

[14] *Id.* In addition, Beshears et al. (2007) studied savings plan participation at nine firms with automatic enrollment and variation in their match structures. Although they caution that the potential existence of firm-level omitted variables means the results should be interpreted with caution, they conclude that the analysis suggests that "moving from a typical matching structure—a match of 50 [percent] up to 6 [percent] of pay contributed—to no match would reduce participation under automatic enrollment at six months after plan eligibility by 5 to 11 percentage points." *See* Beshears, Choi, Laibson, and Madrian, "The Impact of Employer Matching on Savings Plan Participation under Automatic Enrollment," *NBER*

Second, sponsors and administrators of private-sector plans provide extensive participant education on the importance of saving and investing, through materials and website tools, which plays a key supporting role in increasing participation (Figure 1). The depth and breadth of these educational efforts help inform employees of the benefits of the 401(k) plan and the importance of saving for retirement. All of these features contribute to the success of automatic enrollment in the voluntary private retirement system, but it is far from clear that they will be present in the context of state-mandated payroll-deduction IRAs.

Academic research has examined the effectiveness of automatic enrollment in the context of private-sector 401(k) plans that added the feature to already existing plans.[15] These plans typically have extensive educational programs in place, including materials to promote the importance of saving for retirement, explanations of investment types and the trade-off between risk and return, and the features of their plans.[16] Household survey results highlight that about nine in 10 households with DC plan accounts agreed that their employer-sponsored retirement plan helped them to think about the long-term, not just their current needs.[17]

Third, private-sector 401(k) plans offer an array of investment options, typically covering a range of investment risks and returns (Figure 1). Household surveys find that DC-owning households generally appreciate the investment choice and control and agree that their DC plan offers a good line-up of investment options.[18] All of these factors suggest that the Program will find it difficult to replicate the success of the private sector.

A final factor that may depress participation rates for the Program compared with private-sector 401(k) participation rates is the complexity around IRA contribution rules. It is not clear how the educational materials and enrollment process will help workers make sure that their contributions to the Program are within the legal requirements surrounding IRAs, which may result in some workers

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Retirement Research Center Paper, no. NB 07-09, Cambridge, MA: National Bureau of Economic Research (August 2007); available at www.nber.org/aging/rrc/papers/orrc07-09.pdf.

[15] For example, *see* Madrian and Shea, "The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior," *The Quarterly Journal of Economics* 116, no. 4 (2001): 1149-1187; available at http://qje.oxfordjournals.org/content/116/4/1149.abstract.

[16] *See* Plan Sponsor Council of America, *58th Annual Survey of Profit Sharing and 401(k) Plans: Reflecting 2014 Plan Experience*, Chicago: Plan Sponsor Council of America (2015), which reports on the educational materials and activities used in 401(k) plans and the goals of the educational programs. *See also*, Figure 1 in this letter.

[17] *See* Figure 2 in Holden, Burham, Bogdan, and Schrass, "American Views on Defined Contribution Plan Saving, 2015," *ICI Research Report,* Washington, DC: Investment Company Institute (February 2016); available at www.ici.org/pdf/ppr_16_dc_plan_saving.pdf. Results are based on a survey of more than 3,000 U.S. adults from mid-November 2015 to mid-December 2015, of which more than half owned DC plan accounts.

[18] *Id.*

opting out due to confusion,[19] and others having difficulties when they ultimately file their taxes. The instructions for determining IRA contribution eligibility may themselves have the effect of putting off workers.[20]

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[19] The historical data indicate that when traditional IRA contributions were universally allowed from 1982 to 1986, many low-income workers joined the ranks of traditional IRA contributors. When income limits and restrictions based on employer-sponsored retirement plan coverage were placed on traditional IRA contribution eligibility, the data indicate that many lower-income taxpayers stopped contributing, even if they were eligible to make tax-deferred contributions—suggesting confusion around the rules governing contributions. *See* discussion in Holden, Ireland, Leonard-Chambers. and Bogdan., "The Individual Retirement Account at Age 30: A Retrospective," *Investment Company Institute Perspective* 11, no. 1 (February 2005); available at www.ici.org/pdf/per11-01.pdf.

[20] For the instructions on determining IRA contribution eligibility, *see* U.S. Department of Treasury, Internal Revenue Service, "Contributions to Individual Retirement Arrangements (IRAs), For use in preparing 2015 Returns," *Publication 590-A*; available at www.irs.gov/pub/irs-pdf/p590a.pdf.

Figure 1
Private-Sector Retirement Plans Provide a Great Deal of Support

	Private-sector 401(k) plans	Proposed state program
Employer contributions	76% of 401(k) plans covering 88% of 401(k) participants have employer contributions[1]	None
Participant education	68% of 401(k) plans email plan communications[2] 57% websites for the plan 45% individually targeted communications 53% seminars or workshops 40% newsletters 36% retirement gap calculators 29% retirement income projections 17% mobile apps	Plan materials for distribution by employer
Employee contributions	58% of 401(k) plans allow Roth 401(k) contributions[2] All 401(k) plans allow pre-tax contributions	Roth IRA; unless not eligible Deductible traditional IRA; unless not eligible After-tax traditional IRA
Account access	87% of 401(k) participants are in plans that offer loans[3] Hardship withdrawals In-service withdrawals (age 59½ or older)	Hardship withdrawals Penalty-free withdrawals (age 59½ or older)
Investments	Average 27 investment options[4] Default, typically a target date fund[5]	Unclear number of options Default, under review

[1] BrightScope and Investment Company Institute, *The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2013* (December 2015).
[2] Plan Sponsor Council of America, *58th Annual Survey of Profit Sharing and 401(k) Plans: Reflecting 2014 Plan Experience*, Chicago, IL: Plan Sponsor Council of America (2015). Plans provide multiple types of educational materials. Figures reported are percentage of 401(k) plans using the educational material indicated.
[3] Holden et al., "401(k) Plan Asset Allocation, Account Balances, and Loan Activity, 2013," *ICI Research Perspective* and *EBRI Issue Brief* (December 2014).
[4] BrightScope and Investment Company Institute, *The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2013* (December 2015).
Sources: See notes above.

2. Workforce demographics also affect opt-out rates

Workforces of employers without retirement plans differ from those with retirement plans.[21] As the Program is intended to serve workforces at employers that have not voluntarily adopted retirement plans, workforce demographics may adversely affect participation and opt-out rates for the Program relative to those for voluntary private-sector plans.

As is the case nationwide, workforces at California employers without retirement plans tend to be younger, lower-income, and not working full-time, or full-year (Figure 2).[22] In this respect, younger workers tend to be focused on other savings goals and paying down debt, and lower-income workers tend to be focused on saving for emergencies and meeting current needs. Lower income workers are also more likely to receive high replacement rates from Social Security.[23] In California, 35 percent of workers at employers without retirement plans are younger than 30, compared with 22 percent of workers at employers with plans. Fifty-eight percent of workers at employers without retirement plans earn less than $27,000, compared with only 24 percent of workers at employers with plans. Only 57 percent of workers at employers without retirement plans work full-time, full-year, compared with 77 percent of workers at employers with plans.

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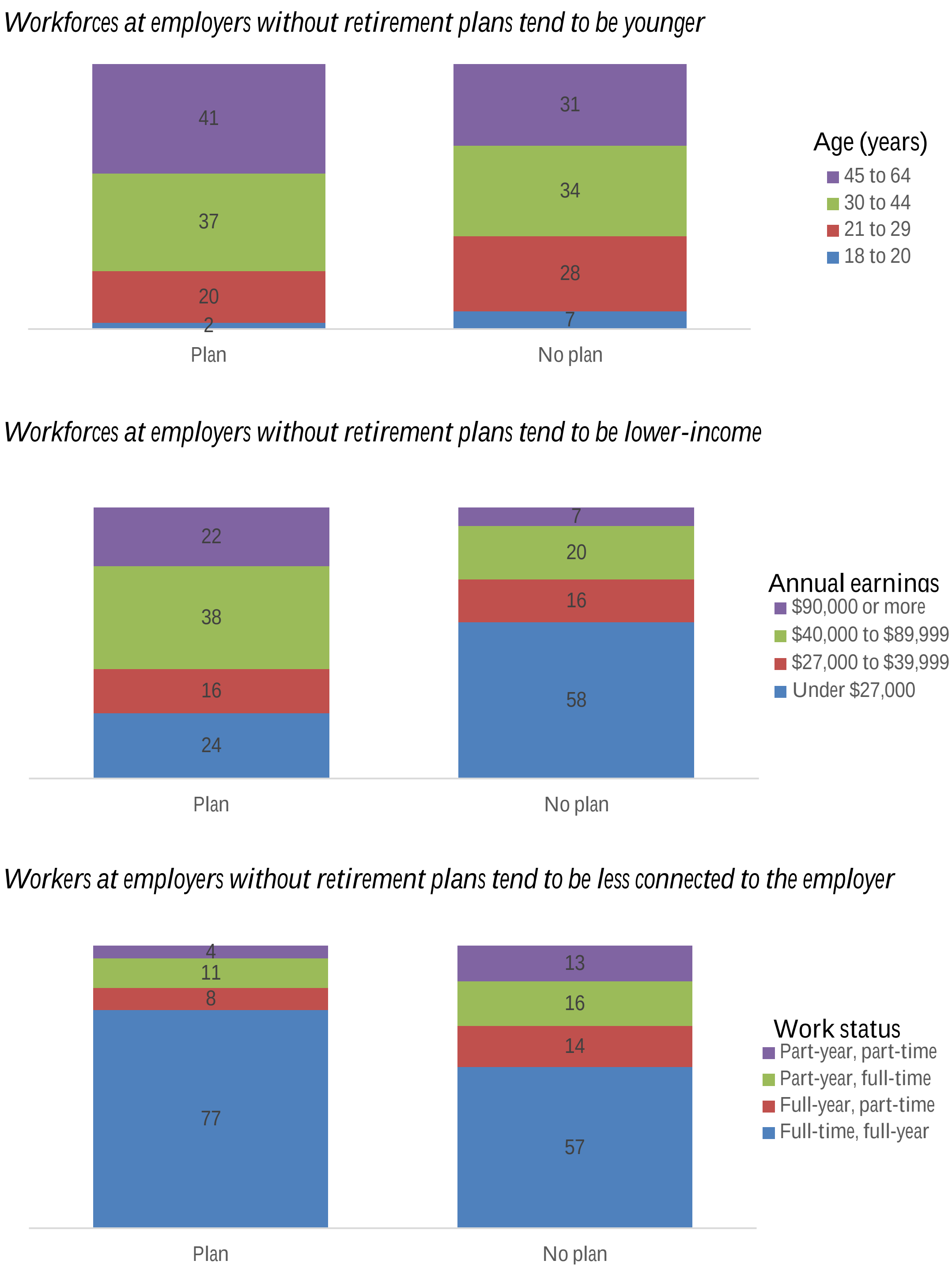
[21] Differences in workforce composition appear to be a primary cause for the lower rate at which small employers sponsor retirement plans. *See* nationwide analysis in Figure 4 and discussion in Brady and Bogdan, "Who Gets Retirement Plans and Why, 2013," *ICI Research Perspective* 20, no. 6 (October 2014); available at www.ici.org/pdf/per20-06.pdf.

[22] ICI used the description of the CPS sample analyzed in the Report to do additional analysis of the pool of eligible California workers (*see* page 26 in the Report). Although, we caution that the latest CPS resulted in a change to the survey that understates retirement plan coverage (*see* note 42). Additionally, there is the difficulty that the weights in the CPS are for national calculations not regional or state-specific. We were able to closely replicate the wage and salary distribution of the eligible California workers, but found different results for employment status. Figure C-6 on page 31 of the Report indicates that 83 percent of eligible California workers are full-time, while our analysis of the CPS data finds that 73 percent are full-time, with the key difference in the percentage that are full-time, full-year, which is 66 percent in the Report, and 57 percent in our analysis of the data (Figure 2 in this letter). It appears that the feasibility study assumes 75 percent of eligible workers are full-time and 25 percent are part-time (*see* page 112 of the Report), even though we believe that it makes more sense to group full-time and not full-year workers with the other workers also less connected to the workforce.

[23] The Congressional Budget Office reports estimated replacement rates from scheduled Social Security payments, and Social Security replaces a higher percentage of pre-retirement earnings for workers in lower-income households than it does for workers in higher-income households. *See* Congressional Budget Office, *CBO's 2015 Long-Term Projections for Social Security: Additional Information* (December 2015); available at www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51047-SSUpdate.pdf.

Figure 2
Workforces at Employers with Retirement Plans Differ from Those Without Plans
Percentage of private-sector wage and salary workers age 18 to 64 in California, 2012–2014



Note: Sample is California private-sector wage and salary workers, age 18 to 64. The data are from CPS conducted in the years 2013–2015, reflecting retirement plan coverage in the prior year (2012–2014).
Source: ICI tabulation of Current Population Survey data

Opt-out rates may impose significant costs on workers, as well. Participants who opt out after accounts have been created may face tax penalties or incur additional consumer debt, perhaps suffering avoidable financial stress. The DOL has expressed concern that certain workers who fail to opt out of state programs may be very economically vulnerable.[24] As explained above, workers at employers without retirement plans often are lower-income (58 percent of California workers without retirement plans at their current jobs have annual earnings of less than $27,000; Figure 2). While analysis of this potential outcome is beyond the scope of the financial feasibility study for the Program, the Board should be mindful of these risks.

3. Opt-out rates will affect the financial feasibility of the Program

As discussed above, research regarding the impact of automatic enrollment cannot predict the Program's opt-out rates, which may prove significantly higher than those predicted by the experience of private-sector automatic enrollment in 401(k) plans. The Report shows that higher opt-out rates will impact the funding and breakeven period for the Program. Its analysis indicates that the breakeven period will increase from 6 to 10 years and the financing needs will increase by 30 percent (from $89 million to $116 million) if the opt-out rate rises from 10 percent to 70 percent (Figure 3). Given sunk costs, fixed-costs, and per-employer costs, it is perplexing that the Report finds that the opt-out rate must rise to 70 percent before that rate has dramatically different effects on Program financing. Although the Report identifies this risk, it does not consider high opt-out rates even in its "pessimistic scenario."

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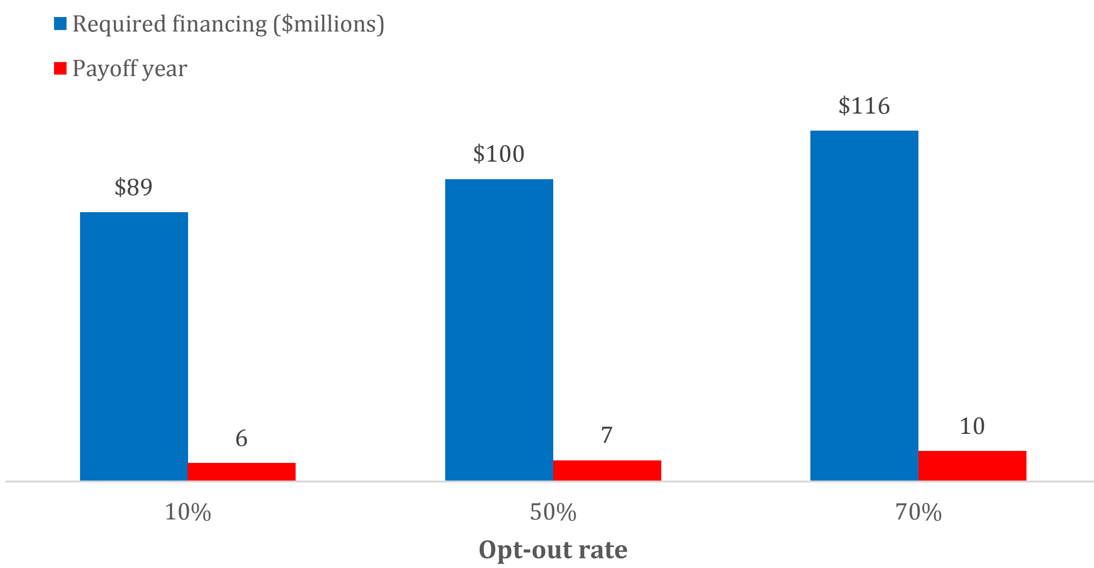
[24] For research supporting this concern, *see* Beshears, Choi, Laibson, and Madrian, "Default Stickiness among Low-Income Individuals," *Social Security Administration Retirement Research Consortium Paper* (October 11, 2012); available at http://gsm.ucdavis.edu/sites/main/files/file-attachments/lowincomedefaults.pdf.

Figure 3
Impact of Opt-Out Rates on Financing Needs to Consider More Scenarios
Opt-out rate changes financing and payoff year little except in the extreme scenario



Note: *See* page 118 of the Report.
Source: Overture Financial Final Report

The Board should analyze more opt-out scenarios and ensure that the underlying calculations fully take into account the impact of sunk costs, fixed costs, and per-employer costs. Figure 4 presents simple numerical examples that highlight the impact of higher opt-out rates on the Program's variable recordkeeping costs. In the first panel, the variable recordkeeping costs from the direct servicing model are calculated for the scenario where there are 100,000 employers offering the Program to their workers. On average, 10 employees per employer participate in the Program, resulting in 1 million participants with IRA balances. The average variable cost of recordkeeping is $35 per participant in this scenario (Example 1). But, what if the opt-out rate is higher and fewer employees decide to open an IRA under the Program? If on average, there were only one participant per employer, the average variable cost of recordkeeping climbs to $170 per participant (Example 2).[25] This is not to suggest that only one worker per employer will participate, but to highlight that the number of participants as well as the number of employers are important to determining the costs of the Program. These calculations do not even take into account sunk or fixed recordkeeping costs or any of the other fixed costs of running the program; the lower the number of accounts, the greater these expenses will be on a per-account basis. Understanding the likely opt-out scenarios is critical to being able to determine whether the Program is economically viable.

Figure 4
Higher Opt-Out Rates Increase the Variable Costs of Recordkeeping

Direct servicing model	Number	Per unit cost	Total cost	Cost per participant account
Example #1				
Employers	100,000	$150	$15,000,000	
Participants	1,000,000	$20	$20,000,000	$35
Example #2				
Employers	100,000	$150	$15,000,000	
Participants	100,000	$20	$2,000,000	$170
EDD servicing model	**Number**	**Per unit cost**	**Total cost**	**Cost per participant account**
Example #3				
Employers	100,000	$120	$12,000,000	
Participants	1,000,000	$17	$17,000,000	$29
Example #4				
Employers	100,000	$120	$12,000,000	
Participants	100,000	$17	$1,700,000	$137

Note: Cost data are for existing employers and participants. Costs would be higher for new employers in the direct servicing model. *See* page 117 in the Report.
Sources: ICI tabulation and Overture Financial Final Report

Figure 5 provides additional numerical examples that highlight how variable recordkeeping costs could be affected depending on the pattern of the opt-out rates across firms even when the same

[25] Examples 3 and 4 in the lower panel of Figure 4 repeat the variable recordkeeping cost exercise using the EDD (State of California Employment Development Department) servicing model.

number of workers open IRAs in the Program (and therefore the aggregate opt-out rate is constant). In the top panel, the variable recordkeeping costs from the direct servicing model are calculated for the scenario where 500,000 workers participate in the Program and open IRAs. These 500,000 workers are employed by 100,000 different employers. The average variable cost of recordkeeping is $50 per participant in this scenario (Example 1). But, what if the 500,000 workers are employed by 300,000 different employers? In this scenario, the average variable cost of recordkeeping rises to $110 per participant (Example 2).[26] This exercise highlights that the number of employers as well as the number of participants are important to determining the costs of the Program.

Figure 5
Different Opt-Out Rates Across Employers Impact the Variable Costs of Recordkeeping

Direct servicing model	Number	Per unit cost	Total cost	Cost per participant account
Example #1				
Employers	100,000	$150	$15,000,000	
Participants	500,000	$20	$10,000,000	$50
Example #2				
Employers	300,000	$150	$45,000,000	
Participants	500,000	$20	$10,000,000	$110
EDD servicing model	**Number**	**Per unit cost**	**Total cost**	**Cost per participant account**
Example #3				
Employers	100,000	$120	$12,000,000	
Participants	500,000	$17	$8,500,000	$41
Example #4				
Employers	300,000	$120	$36,000,000	
Participants	500,000	$17	$8,500,000	$89

Note: Cost data are for existing employers and participants. Costs would be higher for new employers in the direct servicing model. *See* page 117 in the Report.
Sources: ICI tabulation and Overture Financial Final Report

[26] Examples 3 and 4 in the lower panel of Figure 5 repeat the variable recordkeeping cost exercise using the EDD servicing model.

B. If contribution rates are lower than projected, the economic viability to the Program is at risk

The Report finds that contribution rates have a significant impact on Program expenses, the required financing for the Program, and the payoff year. The baseline scenario assumes a 5 percent contribution rate on an average full-time annual salary of $45,000 or an average annual part-time salary of $20,000.[27] Changing the contribution rate to 3 percent raises required financing by $81 million, or 91 percent, extends the payoff year by 3 years, or 50 percent, and increases Program expenses in the first year by 1.61 percentage points, or 51 percent (Figure 6).

Although the Report acknowledges that the contribution rate will have a significant impact on the ultimate financing required, it uses a rate that is higher than the survey results suggest may occur. The Board should consider additional scenarios that include a 2 percent contribution rate, as well as a variety of combinations of contribution rates and opt-out rates.

Figure 6

Financial Feasibility of Program Greatly Impacted by the Contribution Rate

	Required financing ($millions)	Payoff year	Program expenses as a percent of assets		
			Year 1	Year 5	Year 10
(5% contribution rate; 25% opt-out)	$89	6	3.17	0.76	0.45
3% contribution rate	$170	9	4.78	1.07	0.59
Memo:					
Difference	$81	3	1.61	0.31	0.14
% difference	91%	50%	51%	41%	31%

Note: *See* page 118 in the Report.

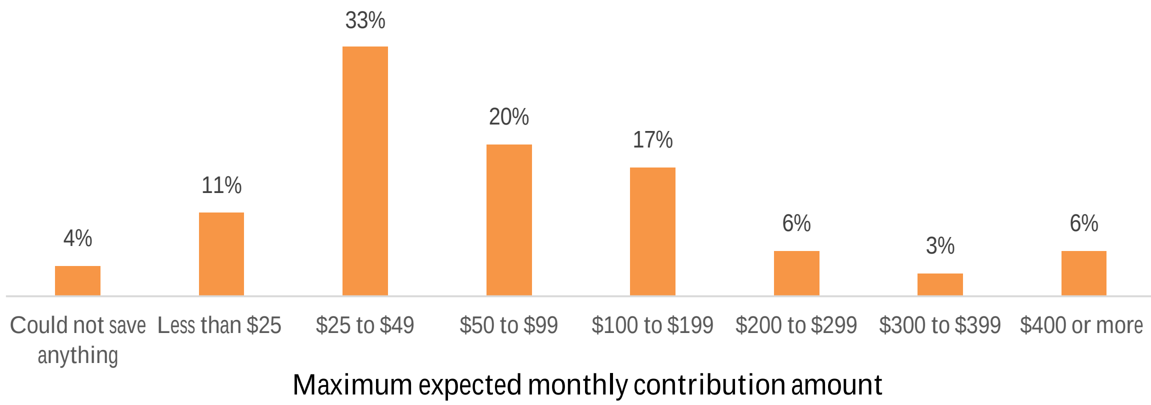
Sources: Investment Company Institute calculations and Overture Financial Final Report

In contrast to the assumed 5 percent contribution rate, the survey results presented in the Report indicate that the majority of eligible workers say they would likely contribute very small amounts into IRAs in the Program. The median maximum expected monthly amount respondents indicated they would likely contribute falls in the $50 to $99 category (Figure 7). Indeed, most eligible workers surveyed said they could contribute to such a program, but 64 percent indicated that the

[27] *See* page 112 in the Report.

maximum they could contribute would be less than $100 a month, including one-third who said the most they could contribute was between $25 and $49 a month.

Figure 7
Eligible Workers Report Possible Contribution Amounts That Are Modest
Percentage of respondents, 2015



Note: Sample is 1,000 respondents; workers not offered retirement plans at work.
Source: Greenwald & Associates Online Survey

Such contribution amounts would generate much smaller accounts than those estimated in the baseline scenario in the feasibility study in the Report. Based on the respondents' maximum likely contributions, the average annual contribution would range from about $1,000 to about $1,700, which is well below the average annual contribution assumed in the feasibility study. The Report projected 1.6 million participants with $3.2 billion in assets after one year, which is an average account of about $2,000.[28]

Corroborating what the survey found with regard to contribution amounts, the wage composition of the uncovered California workers also suggests that many accounts will have only modest contributions. One-fifth of eligible California workers have annual salaries less than $10,000 (Figure 8). Even if the Board were to focus on eligible California workers who are employed full-time and full-year, one-fifth of those workers have annual salaries of $20,151 or less. Given that 57 percent of eligible workers are full-time, full-year (Figure 2), 43 percent are less connected to the workforce and more likely to be lower-income and experiencing financial stresses.

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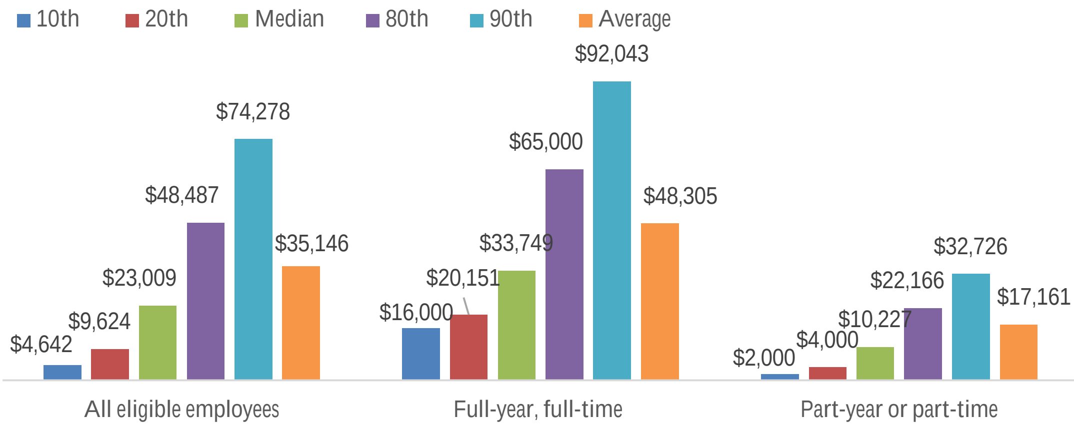
[28] *See* page 114 in the Report.

Figure 8
Wage Distribution of Eligible California Employees
Percentiles and average of annual earnings, 2012–2014



Note: Data for all eligible employees are from Figure C-4 on page 30 of the Report. Data for full-time, full-year, versus part-year or part-time are from Investment Company Institute tabulations of Current Population Survey data. ICI tabulations indicate that 57 percent of eligible California workers are full-time, full-year, and 43 percent are part-time or part-year (see Figure 2 above).
Sources: Overture Financial Final Report and Investment Company Institute tabulations of the Current Population Survey

C. Withdrawal activity and turnover may be higher than assumed in the Report

Because the Program represents an entirely new set of enrollment and participation experiences, it is not possible to extrapolate from private-sector experience with withdrawals and turnover. Additional scenarios should be stress-tested to determine the impact of withdrawals and turnover on the asset growth and costs of the Program, and hence on its financial feasibility. There are several variables that would affect withdrawal activity and turnover: (1) access to account balances for self-certified hardship withdrawals; (2) behavior at job change of participants in a mandatory automatic enrollment program; (3) IRA rules which permit individuals to change financial services providers at any time; and (4) realization by participants that a private-sector IRA may offer a more attractive investment opportunity.

Research on withdrawal activity and rollover and cash-out behaviors at job change or retirement has largely been based on the behavior of participants in retirement plans with voluntary enrollment. Even for plans with automatic enrollment, the employer had the choice to set up automatic enrollment, not the requirement to do so. Moreover, research shows that the availability of plan loans in 401(k) or other DC plans helps contribute to low withdrawal rates while working, because typically a plan participant must take a loan before seeking a withdrawal. Thus, withdrawal rates in employer-sponsored DC plans will not provide insight into the withdrawal activity that might occur in the Program.

One might then consider withdrawal activity among IRA investors, but again, the withdrawal activity among IRA investors who have voluntarily created their IRAs may not provide a good measure of withdrawal activity in the Program.

The Report assumes that worker turnover is the sole factor in determining withdrawals. Linking withdrawal activity solely to worker turnover, however, ignores the fact that participants in the program will also have the ability to change service providers and therefore likely understates the extent of potential participant withdrawals from the Program. The Report indicates that participants will shoulder the start-up and fixed costs of the plan in addition to a 0.18 percent investment management fee. Total participant fees will be capped at 1.00 percent per year, with excess revenue from this fee used to pay back the costs of the Program in the initial years.[29] Effectively, the Program places the burden of start-up costs on participants in the Program, with the promise of eventual lower fees when those start-up costs have been recovered.

It is far from certain these participants will stick with the Program to eventually experience the lower fees. If the Program creates true IRAs, participants may change service providers, or transfer their IRA balances from one service provider to another, at any time.[30] Workers not covered by retirement plans at their current employers have access to the vibrant IRA market, which is served by a range of financial services firms offering a wide variety of investment options.[31] Indeed, 61 percent of traditional IRA–owning household with rollovers indicated that one of the reasons they rolled over the assets from their employer-sponsored retirement plans was to get access to more investment options (with 21 percent saying that was the primary reason they rolled over) and 48 percent rolled over to use a different financial services firm.[32]

Program participants also may realize that they could find a far more attractive deal in the private sector, with additional investment choice, flexibility, and lower-cost options. Private-sector IRA investors are able to obtain lower-cost fund investing and, indeed have concentrated their assets in

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[29] *See* pages 115 and 117 in the Report.

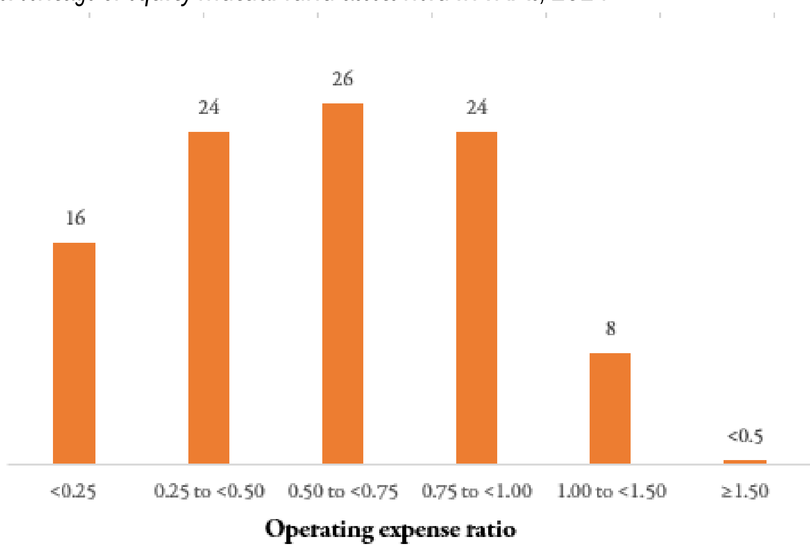
[30] "A transfer of funds in your [IRA] from one trustee directly to another, either at your request or at the trustee's request, is not a rollover. This includes the situation where the current trustee issues a check to the new trustee but gives it to you to deposit. Because there is no distribution to you, the transfer is tax free. Because it is not a rollover, it is not affected by the 1-year waiting period required between rollovers." For the rules on IRA transfers, *see* U.S. Department of Treasury, Internal Revenue Service, "Contributions to Individual Retirement Arrangements (IRAs), For use in preparing 2015 Returns," *Publication 590-A*; available at www.irs.gov/pub/irs-pdf/p590a.pdf.

[31] *See* Holden and Schrass, "The Role of IRAs in U.S. Households' Saving for Retirement, 2015," *ICI Research Perspective* 22, no. 1 (February 2016); available at www.ici.org/pdf/per22-01.pdf.

[32] *Id.*

lower-cost mutual funds. For example, at year-end 2014, more than 90 percent of IRA equity mutual fund assets were in equity mutual funds with operating expenses of less than 1.0 percent, including 40 percent with operating expenses less than 0.50 percent (Figure 9).[33] All of these factors could be expected to lead to higher turnover and withdrawal activity than the Board may anticipate.

Figure 9
IRA Investors Concentrate Their Assets in Lower-Cost Mutual Funds
Percentage of equity mutual fund assets held in IRAs, 2014



Note: This figure reports the distribution of equity mutual fund assets held in IRAs by mutual fund operating expenses so as to focus on investment management expenses (rather than total mutual fund expense ratios which would include the 12b-1 fees investors pay through the fund for some or all of the services they receive from financial professionals and other financial intermediaries). The operating expense ratio is reported as a percent of assets. Components do not add to 100 percent because of rounding.
Sources: Investment Company Institute and Lipper

D. Program costs may be higher than projected, which will burden Program participants, California taxpayers, or both

The Report does not appear to have contemplated all the costs of the Program. The Report rightly indicates that "[a]dministering the California Secure Choice Program represents the single

[33] If one analyzes the distribution of IRA mutual fund assets by total fund expense ratio, it also is clear that IRA investors concentrate their assets in lower-cost mutual funds. *See* "Statement of the Investment Company Institute, Brian Reid, Chief Economist, Hearing on 'Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees,' Subcommittee on Health, Employment, Labor, and Pensions Committee on Education and the Workforce, United States House of Representatives" (June 17, 2015); available at www.ici.org/pdf/15_house_advice.pdf.

largest cost item and can be the primary determinant of its financial feasibility."[34] But the analysis does not include enforcement costs,[35] and it is not clear the extent to which it fully considers compliance costs.[36]

Some assumptions on patterns of participation in the Program could have significant impact on the cost of administering the Program. The feasibility exercise, for example, appears to focus on the number of IRAs actually created, but the number of IRAs attempted but not created could also drive costs higher. The Report estimates that "10 percent of [the 6.3 million eligible California participants] would not have a valid Social Security number and so would not participate."[37] Opting those non-participants out of the system could incur processing costs, including the cost of resolving their Social Security number issues. As explained on page 14 in the Report, in the EDD (State of California Employment Development Department) servicing model, the recordkeeper may also need to provide refunds if payroll deduction commences before the recordkeeper resolves the Social Security number issues. In either scenario, the recordkeeper will incur costs related to sorting out the situation with these workers (Figure 10).

[34] *See* page 91 of the Report.

[35] *See* page 113 of the Report.

[36] On page 93, the report states that: "In both models [EDD or direct servicing recordkeeping], EDD runs employer education outreach/campaign and possibly performs compliance and audit functions." It is difficult to figure out where this cost is accounted for on page 117 of the Report, which provides a detailed breakdown of expense drivers. Enforcement, compliance, and audit costs could prove substantial, and their role in the current analysis should be clarified.

[37] *See* page 112 in the Report.

Figure 10
Sorting Out Social Security Issues May Result in Costly Recordkeeping

Topic	Recommendation
Employer Role in Social Security Number (SSN) Validation	**Normal employment eligibility verification process.** **NOTE:** Include requirement for Recordkeeper to accept this as part of the RFP to select Recordkeeper.
Recordkeeper & EE Roles	**Recordkeeper performs electronic validation of identity of new enrollees; contacts EE (not ER) regarding invalid SSN.** Under the Direct Service model, no account is created, and payroll deduction for that EE does not commence until issue is resolved. **EE responsible for taking action to resolve issue** -- correct SSN/name, provide TIN, or opt out—within a 45 day period. **If no resolution or EE opts out, Recordkeeper takes no further action.** Under the EDD-as-Intermediary model, there may be a need for refunds if payroll deduction commences before the Recordkeeper has the opportunity to process SSN issues.

Note: *See* page 14 in the Report.
Source: Overture Financial Final Report

Another problem with the Report is it assumes that workers who are between jobs do not have an impact on Program costs. The Report states that "at any single point in time, about 10 [percent] of full-time workers and 25 [percent] of part-time workers would be in between jobs and not represented on any employer payroll."[38] Even if those estimates are accurate, they do not appear to account for part-year and seasonal workers who will not make periodic contributions throughout the entire year and could end up with smaller balances, which will result in higher per-account costs in the Program.

[38] *See* page 112 in the Report.

The Report also does not appear to consider the full extent of the costs to the Program of developing and delivering participant education or communications to report account activity, account balances, and other matters. Employers provide extensive educational materials about private-sector 401(k) plans through multiple touch points. In the IRA market, financial services firms provide extensive materials about opening and investing in IRAs, and have systems in place to comply with Form 5498 and 1099-R reporting requirements. As an entirely new program involving mandatory automatic enrollment, the Program will require extensive educational materials and multiple communication channels to explain the Program to employers and workers. The cost of such materials, initially and on an ongoing basis, needs to be fully incorporated into the feasibility analysis. The Report indicates that education and communication materials will be developed by EDD and the recordkeeper, with "EDD collaborat[ing] on employer outreach and training,"[39] but the Report does not clearly spell out the extent to which costs associated with education and communication materials for both employers and employees have been incorporated into the feasibility study.[40] Any incorrect estimate of the cost of creating and maintaining these materials, communication channels, and reporting systems would impact the financial feasibility of the Program.

II. Many Workers Not Covered by Employer-Sponsored Retirement Plans Have Other, More Pressing Financial Needs

In addition to concerns about the accuracy of the Report's findings and financial viability of the Program, we believe that it is important for the Board to appreciate that—in contrast to a fundamental assumption underlying the perceived need for mandatory state-run retirement plans —workers currently not covered by employer-sponsored retirement plans may not be best served by automatic enrollment into such programs. In this respect, analysis of the data on retirement plan coverage suggests that workers not currently covered by retirement plans tend to have other, more pressing financial needs or savings goals. The Board should be thoughtful about potentially causing inadvertent harm to workers who fail to opt out but really cannot afford to contribute to the plan.[41] Analysis of household

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[39] *See* page 100 in the Report.

[40] *See* page 117 in the Report. Expenses for call centers, contribution processing and "marketing" are listed; but it is not clear how the estimates were arrived at or the extent to which the development and maintenance of educational and communication materials (for both employers and employees) has been fully captured.

[41] Significantly, in the notice accompanying its proposed safe harbor regarding state plan programs, DOL mentions that such inadvertent savings could cause damage to the overall household balance sheet if, for example, debt were incurred or not paid down. DOL mentions the possibility that a college student might reasonably focus on paying down student loans and a young family might focus on saving for education. 80 Fed. Reg. 72012. Household survey data from the Survey of Consumer Finances provide evidence that there is a life cycle of saving: Households tend to focus on building education, a family, or money to purchase a home earlier in life, before focusing on saving for retirement later in life; *see* Figure 1 in Brady and Bogdan, "Who Gets Retirement Plans and Why, 2013," *ICI Research Perspective* 20, no. 6 (October 2014), available at www.ici.org/pdf/per20-06.pdf; *see also* Figure 7.2 in Investment Company Institute, *2015 Investment Company Fact Book: A Review of Trends and Activities in the U.S. Investment Company Industry* (2015), available at www.icifactbook.org. In addition, the Federal Reserve Bank of New York Consumer Credit Panel data indicate that in 2015:Q4, student loan debt

balance sheet data indicates that households without retirement accumulations tend to face significant and immediate pressing financial stresses, which would only be heightened if they are automatically enrolled into these plans and a portion of their wage income is set aside into a retirement savings account.

A. The Report does not reflect the complexity of factors associated with retirement plan coverage or the potential for economic harm to workers

Discussions about retirement plan coverage often rely on misleading or incomplete coverage statistics. The Institute has published extensive research on the difficulties that arise in determining the scope of retirement plan coverage. The most commonly used data understate retirement plan coverage,[42] and the most commonly used measure—a snapshot of coverage at a single point in time across workers of all ages, incomes, and degrees of attachment to the workforce—is not a good

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was $1.2 trillion, which is larger than the $0.7 trillion in credit card debt and the $1.1 trillion in auto loan debt. *See* Federal Reserve Bank of New York, The Center for Microeconomic Data, *Consumer Credit Panel, Household Debt & Credit*, "2015:Q4 Data;" available at www.newyorkfed.org/microeconomics/data.html. Federal Reserve Board researchers note that "[t]he level of education loan debt held by U.S. families has increased dramatically over the past decade;" *see* page 26 in Bricker et al., "Changes in U.S. Family Finances from 2010 to 2013: Evidence from the Survey of Consumer Finances," *Federal Reserve Bulletin* 100, no. 4 (September 2014); available at www.federalreserve.gov/pubs/bulletin/2014/pdf/scf14.pdf. They also analyze how education debt burden varies across households.

[42] The most commonly used data to analyze retirement plan coverage is the Current Population Survey (CPS), which is a household survey. The CPS typically shows lower rates of pension coverage than surveys of business establishments, such as the National Compensation Survey (NCS). For example, the CPS data show that 59 percent of all full-time, full-year private-sector wage and salary workers had pension coverage in 2013 (pension coverage includes DB and/or DC plans; ICI tabulations of 2014 CPS data). The March 2014 NCS, on the other hand, shows that 65 percent of all private-industry workers and 74 percent of all full-time private-industry workers had access to a pension. *See* Table 1 in U.S. Department of Labor, Bureau of Labor Statistics, "Employee Benefits in the United States—March 2014," *News Release* USDL-14-1348 (July 25, 2014); available at www.bls.gov/ncs/ebs/sp/ebnr0020.pdf. The March 2015 NCS reports that 66 percent of all private-industry workers and 76 percent of all full-time private-industry workers had access to a pension. *See* U.S. Department of Labor, Bureau of Labor Statistics, "Employee Benefits in the United States—March 2015," *News Release* USDL-15-1432 (July 24, 2015); available at www.bls.gov/news.release/pdf/ebs2.pdf.

The analysis in Figure 11 uses the March 2014 CPS data which provide insight into benefits available in 2013. The CPS, which tends to understate retirement plan coverage, changed the survey in March 2015 and the survey changes inadvertently impacted the retirement plan coverage question responses. The March 2015 CPS data for 2014 find that retirement plan coverage dropped in 2014, particularly among the groups of workers most likely to have retirement plans at work. Copeland (2015) concludes that "[t]he unexplainable decreases in the participation level after the CPS redesign and the conflicting time series of the participation levels in CPS relative to other surveys raise doubts about the use of CPS data to assess future retirement plan coverage policies." *See* Copeland, "The Effect of the Current Population Survey Redesign on Retirement-Plan Participation Estimates," *EBRI Notes* 36, no. 12, Washington, DC: Employee Benefit Research Institute (December 2015): 1–11; available at www.ebri.org/pdf/notespdf/EBRI_Notes_12_Dec15_CPS-WBS.pdf.

indicator.[43] It is important to understand the typical characteristics of the workers at employers that do not offer plans in order to formulate effective solutions to increasing coverage among the minority of workers who are without access.

As explained below, the majority of private-sector workers without employer-sponsored retirement plan coverage are younger, lower-income, or less connected to the workforce. This is the case whether the data are examined for the nation as a whole, or for the State of California. As a result, many of these workers may face financial stresses and savings priorities more pressing than retirement saving.

B. Workers not currently participating in retirement plans at work may have other, more pressing financial priorities

Without a doubt, inadequate retirement savings can affect a retiree's ability to meet basic needs, such as needs for food, housing, health care, and transportation. For many workers not covered by employer-sponsored retirement plans, the difficulty in meeting these basic needs does not begin in retirement, but occurs during their working years as well. Workers not currently covered by employer-sponsored retirement plans—who tend to be younger, lower-income, or less connected to the workforce—may have other, more immediate savings priorities. Part-time employment in particular may be a signal of financial stress.

In its proposed ERISA safe harbor regulation, DOL notes that the state initiatives might have some unintended consequences for such workers, explaining:

> Workers who would not benefit from increased retirement savings could opt out, but some might fail to do so. Such workers might increase their savings too much, unduly sacrificing current economic needs. Consequently they might be more likely to cash out early and suffer tax losses, and/or to take on more expensive debt. Similarly, state initiatives directed at workers who do not currently participate in workplace savings arrangements may be imperfectly targeted to address gaps in retirement security. For example, a college student might be better advised to take less in student loans rather

[43] The most commonly used measure to judge retirement plan coverage is a snapshot of coverage at workers' current employers across the entire private-sector workforce. This measure is a poor indicator of whether households will have retirement plan coverage at some point over their lifetimes and approach retirement with retirement accumulations. If this snapshot measure is refined to take into consideration the lifecycle of saving, to recognize the role that Social Security plays in replacing lifetime wage income for lower-income households, and to account for the degree of connection to the workforce—it is clear that the majority of private-sector workers most likely to contribute to an employer-sponsored retirement plan have pension plan coverage as part of their compensation. *See* Brady and Bogdan, "Who Gets Retirement Plans and Why, 2013," *ICI Research Perspective* 20, no. 6 (October 2014); available at www.ici.org/pdf/per20-06.pdf. Put another way, the number of private-sector workers who are likely to be focused on saving for retirement but do not have access to an employer-sponsored retirement plan is lower than suggested by a cursory look at the aggregate data.

> than open an IRA, and a young family might do well to save more first for their children's education and later for their own retirement.[44]

As important as retirement savings is, DOL is correct to point out that these workers may have other priorities for take-home pay. The data suggest that about three-quarters of private-sector workers without retirement plan coverage may be focused on other savings goals or experiencing other financial stresses. The policy rationale underlying the state initiatives does not give adequate consideration to the fact that lack of retirement savings is not the beginning of the financial difficulties for many of these individuals. It also does not give due regard to the important resource that Social Security plays in replacing earnings for U.S. retirees, particularly lower-income workers, who get high earnings replacement rates from Social Security.[45]

A substantial portion of private-sector workers not currently covered by retirement plans at work may face immediate financial stresses. Among the 50.6 million private-sector wage and salary workers aged 21 to 64 who work for employers that do not sponsor retirement plans, nearly four in 10 (39 percent) work only part-time or part-year (Figure 11).

Part-time or part-year work in a given year may be an indicator of financial stress, whether it is a long-term or temporary situation. If these workers usually work part-time or part-year, they are less likely to have additional disposable income to reduce their current consumption to save for retirement, because the vast majority of part-time, part-year workers have low earnings.[46] As low lifetime earners, these workers likely will receive a high earnings replacement rate from Social Security.[47] If some of these workers who are currently working part-time or part-year usually work full-time or for a full year, then earnings in the current year likely are below their typical earnings, and these individuals are unlikely to want to reduce current consumption further by saving—for retirement or for any reason. In either case, part-time, part-year workers are unlikely to be focused on saving for retirement in the current year.

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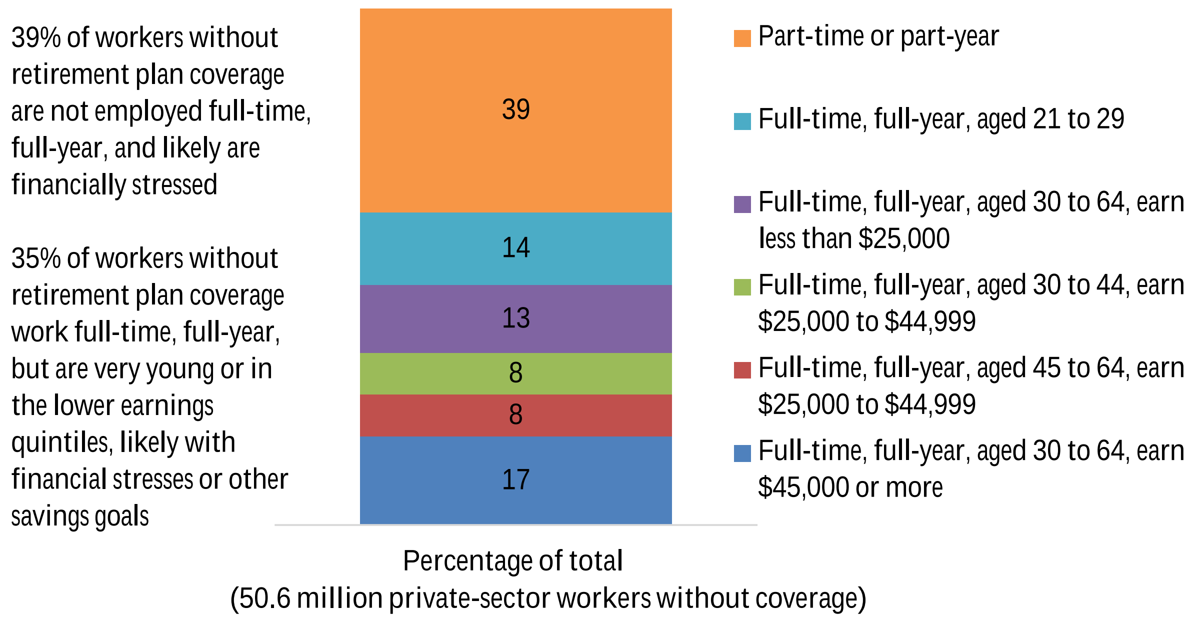
[44] 80 Fed. Reg. 72012.

[45] The Congressional Budget Office reports estimated replacement rates from scheduled Social Security payments, and Social Security replaces a higher percentage of pre-retirement earnings for workers in lower-income households than it does for workers in higher-income households. *See* Congressional Budget Office, *CBO's 2015 Long-Term Projections for Social Security: Additional Information* (December 2015); available at www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51047-SSUpdate.pdf.

[46] *See* Tables 41 and 42 in Brady and Bogdan "Supplemental Tables for Who Gets Retirement Plans and Why, 2013;" available at www.ici.org/info/per20-06_data.xls.

[47] *See* note 45.

Figure 11
About Three-Quarters of Workers Without Retirement Plan Coverage Likely Have Other Financial Priorities
Percentage of private-sector wage and salary workers, aged 21 to 64, whose employers do not sponsor a retirement plan, 2013



Note: Components do not add to 100 percent because of rounding. *See* Figure 6 in the research paper for additional detail.
Source: Investment Company Institute tabulations of March 2014 Current Population Survey; *see* Brady and Bogdan, "Who Gets Retirement Plans and Why, 2013," *ICI Research Perspective* 20, no. 6 (October 2014)

Another 35 percent of private-sector workers without retirement plan coverage at work are very young or lower earners (Figure 11), which suggests they may well have other savings goals, have less need to supplement Social Security benefits, or have other financial stresses. Of this 35 percent, the 14 percent who are full-time, full-year but aged 21 to 29 are likely to be saving for other goals, such as a home, for the family, or education.[48] The primary concern for the 13 percent of full-time, full-year

[48] According to 2013 Survey of Consumer Finances data, 32 percent of households with head of household aged 21 to 29 indicate that saving for home purchase, the family, or education is their primary savings goal, while only 13 percent of such young households report that retirement is their primary savings goal. *See* Figure 7.2 in Investment Company Institute, *2015 Investment Company Fact Book: A Review of Trends and Activities in the U.S. Investment Company Industry* (2015); available at www.icifactbook.org. Household education loan debt has grown in recent years; *see* discussion in note 41.

private-sector workers aged 30 to 64 earning less than $25,000 per year more likely will be that they do not have enough to spend on such immediate needs as food, clothing, and shelter. In fact, many are eligible for government income assistance so that they will be able to spend more than what they earn on these items. If these workers consistently have low earnings throughout their careers, Social Security will replace a high percentage of their lifetime earnings, allowing these workers to use more of their wage income to meet current needs and allowing them to delay additional saving for retirement.[49] The remaining 8 percent of private-sector workers age 30 to 44 who earn between $25,000 and $44,999 a year may have the ability to save, but may have other saving priorities, such as starting a household and providing for the needs of their children. Given that they get a substantial replacement rate from Social Security, they are likely to delay saving for retirement until later in life.[50]

Analysis of household balance sheet data indicates that households without retirement accumulations are more likely to face significant and immediate pressing financial stresses compared with those with retirement accumulations. Focusing on older households who have had much of a lifetime to address retirement savings needs, the data show that those without retirement accumulations tend to have indicators of financial stress.

Figure 12 examines older households—those with a head aged 55 to 64, whether working or not—by their retirement accumulation status. Retirement accumulations can be in the form of DC plans, IRAs, or defined benefit (DB) plan benefits. Older households without retirement accumulations are more likely to report that they received income from public assistance: 35 percent of households without retirement accumulations, compared with 4 percent with retirement accumulations. Older households without retirement accumulations are more likely to be lower income: 52 percent are in the lowest per capita household income quintile, compared with 8 percent of households with retirement accumulations. More than one-quarter (27 percent) of older households without retirement accumulations have no health insurance and almost one-quarter (23 percent) do not have checking accounts. All told, 76 percent of older households without retirement accumulations face at least one of these financial stresses, compared with only 20 percent of households with retirement accumulations.

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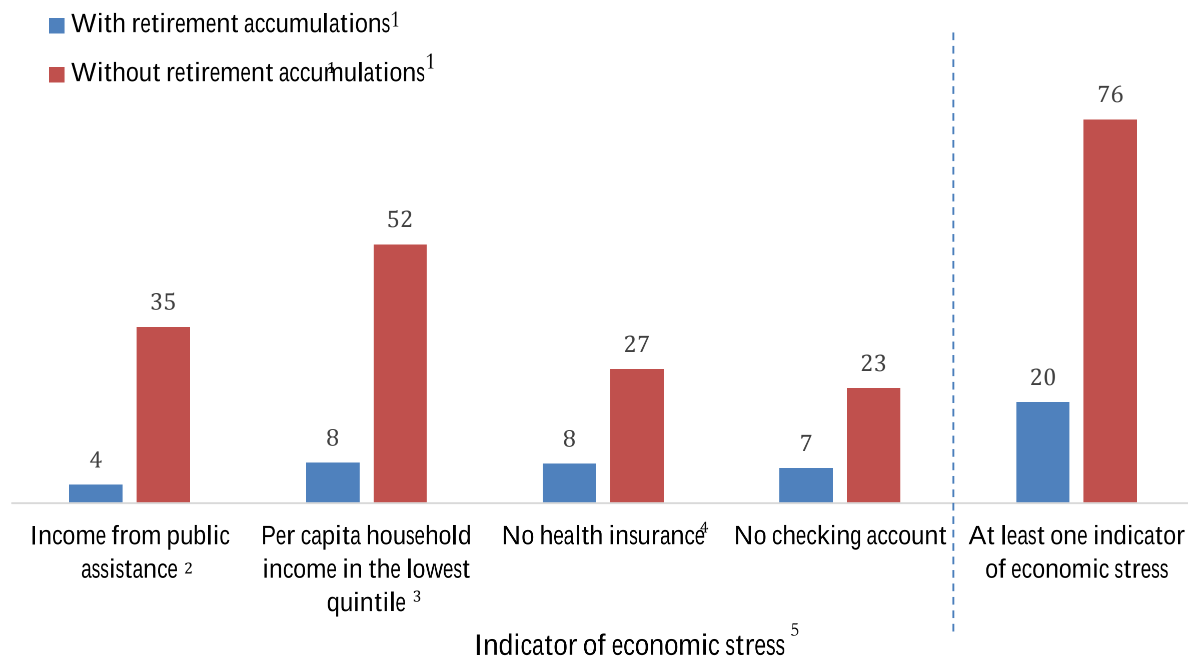
[49] For a simulation exercise that explores the relationship and timing of 401(k) plan saving taking into account the role that Social Security plays for American workers in preparing for retirement, *see* Brady, "Who Benefits from the U.S. Retirement System," *ICI Research Perspective* 21, no. 7 (November 2015); available at www.ici.org/pdf/per21-07.pdf.

[50] *See* Brady and Bogdan, "Who Gets Retirement Plans and Why, 2013," *ICI Research Perspective* 20, no. 6 (October 2014); available at www.ici.org/pdf/per20-06.pdf and Tables 41 and 42 in Brady and Bogdan, "Supplemental Tables for Who Gets Retirement Plans and Why, 2013;" available at www.ici.org/info/per20-06_data.xls.

Figure 12

Older Households Without Retirement Accumulations Tend to Have Financial Stresses

Percentage of U.S. households aged 55 to 64 by retirement accumulation status, 2013



[1] Retirement accumulations include retirement assets and DB benefits. Retirement assets include DC plan assets (401(k), 403(b), 457, thrift, and other DC plans) and IRAs (traditional, Roth, SEP, SAR-SEP, and SIMPLE), whether from private-sector or government employers. DB benefits include households currently receiving DB benefits and households with the promise of future DB benefits, whether from private-sector or government employers.

[2] Income from public assistance includes TANF, SNAP, and other forms of welfare or assistance such as SSI.

[3] Households with a head aged 55 to 64 at the time of the survey were ranked by per capita household income before taxes in 2012.

[4] No health insurance indicates that no individual in the household had public or private health insurance.

[5] Households may fall into multiple categories.

Note: The sample represents 23.0 million households with head of household aged 55 to 64 in 2013; 73 percent had retirement accumulations and 27 percent did not.

Source: Investment Company Institute tabulations of 2013 Survey of Consumer Finances

C. Workers have access to many tax-advantaged retirement savings opportunities

It is certainly essential that workers have easy access to tax-advantaged retirement savings opportunities to supplement the broad-base of the Social Security system. This premise has served as the foundation for the strong voluntary U.S. retirement system. Millions of workers in California have such access already through employer-sponsored retirement plans. For those without employer-sponsored retirement plans, access is available through traditional IRAs (since 1974), Roth IRAs (since

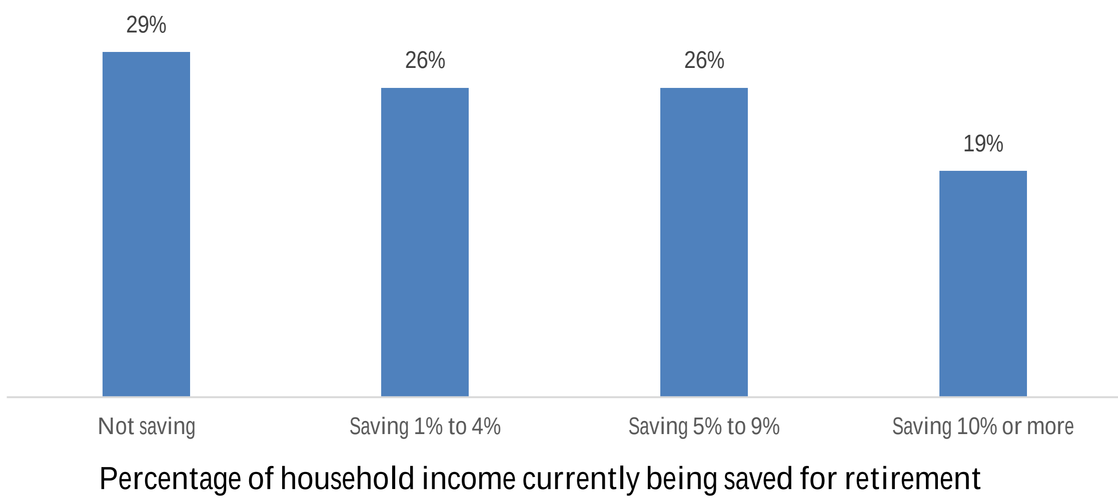
1998), and myRAs (since November 2015). Traditional and Roth IRAs can easily be opened through a variety of avenues—whether through investment professionals or directly with a mutual fund company or discount broker—and myRA is available online.[51] As federal options, these different IRAs are available to workers across the country, regardless of state of residence or changes in state of residence.

Thus, before the State of California embarks on creating another plan, it should remember that such access exists for the more than 6 million California workers who do not have employer-sponsored retirement plans at their current jobs. Indeed, the Report indicates that 71 percent of eligible workers were saving for retirement already, with 45 percent indicating they were saving 5 percent or more for retirement (Figure 13). Many even may be saving in an employer-sponsored retirement plan, as Current Population Survey (CPS) data indicate that about 10 percent of uncovered California workers have a spouse whose employer offers a plan.[52]

[51] Traditional IRA–owning households surveyed in mid-2015 report that 80 percent of traditional IRA–owning households hold traditional IRAs through investment professionals such as full-service brokerages, independent financial planning firms, banks or savings institutions, or insurance companies, and 33 percent hold traditional IRAs directly through mutual fund companies or discount brokerages (households may have multiple traditional IRAs). *See* Holden and Schrass, "Appendix: Additional Data on IRA Ownership in 2015." *ICI Research Perspective* 22, no. 1A (February 2016); available at www.ici.org/pdf/per22-01a.pdf. In addition, firms and individuals interested in the myRA can learn more and set up accounts at https://myra.gov.

[52] ICI tabulation of the same sample studied in the Report, which represents 6.8 million California workers without employer-sponsored retirement plan coverage at their current jobs, 2012–2014.

Figure 13
Majority of Uncovered Workers Already Are Saving for Retirement
Percentage of respondents, 2015



Note: Sample is 1,000 respondents; workers not offered retirement plans at work.
Source: Greenwald & Associates Online Survey

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The Board must engage in further study before taking any action to recommend moving forward with the Program. Analysis of the data provides reasons to believe that the Program will not be as effective at increasing retirement plan participation and savings in California as the Report assumes. The Program is dramatically different than the voluntary retirement plan system in which automatic enrollment has been so successful. The Report likely underestimates the true costs of setting up and running the Program and would benefit from deeper analysis of scenarios that consider the impact of higher opt-out rates, variation in opt-out rates across employers, lower contribution rates, higher levels of withdrawal and turnover activity, and more comprehensive cost estimates.

In addition, the Institute believes strongly that policies that cooperate with, rather than coerce, employers, who best know the demographics and needs of their workers, present far more efficient and effective solutions for expanding coverage.

We hope you find the foregoing comments helpful to your consideration of the Report. If you need additional information or you have questions regarding our comments, please feel free to contact me at (202) 326-5815 or david.blass@ici.org; Sarah Holden, Senior Director, Retirement and Investor Research, at (202) 326-5915 or sholden@ici.org; or David Abbey, Deputy General Counsel – Retirement Policy, at (202) 326-5920 or david.abbey@ici.org. We welcome the opportunity to discuss these comments further or to provide additional information to you and your staff as you work on this important issue.

Sincerely,

/s/ David W. Blass

David W. Blass
General Counsel

Story: Jan, Sacramento

My name is Jan, and I live in Sacramento. I would like to take this opportunity to thank the board for their work, and to request that they strongly consider option 2, the pooled IRA with a reserve, which will ensure a stable fund that provides the greatest return and the lowest risk for low-income families like mine.

I started working at Bank of America in the 1960's. I was divorced, raising 2 kids on my own, and needed to find a way to feed my kids. Fortunately, my mother was able to care for them after school, but things were a real struggle. There was no 401k back then. I worked in banking for 38 years. In banking everything is very organization, planned, taken care, but me, I had to take care of myself, no one was watching out for me.

When my mom got older, I had to take care of her. That was hard, too, juggling it all, though she'd done so much for me that I was grateful to be able to give back.

I moved up to Sacramento from the Bay when my grandkids were born. I wanted to be able to see them, to help out. I couldn't find a job when I moved, though – the only thing they'd offer me was teller, which would have been like going back to the starting line. It would have been a huge cut in pay. I was 58, and apparently, too old. If they can hire someone young, why hire me? I had so experience to bring, but they didn't value that. I finally took a job as a receptionist at Super Cuts, though – I needed the money.

I spent 2.5 years on the waiting list to get into affordable senior housing, where I live now. I became a weekend monitor, thought it would help bring in a little extra money, but then I found out I'd gone $35.12 over the limit for my medical – now I have to pay for it myself. I get $1100 in Social Security – that's all I live on – so any additional medical costs really add up.

I really value getting to live here – I don't know what I'd do without it. My grandson takes me to get groceries once in a while, I see my kids, but I can't depend on them for everything. I'm going to be 80 this year – I don't want my grandchildren to be in the same situation as me – they deserve better. We all do.

Economic Studies at BROOKINGS

March 2016

Getting the Best Program Design for California Secure Choice Requires Flexibility

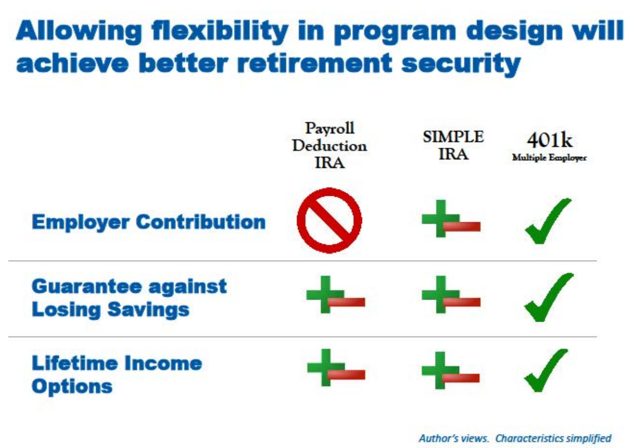
*Comments by Hon. Joshua Gotbaum**

Having worked for several years on secure choice proposals in several states and being a member of the legislative commission to design a program for the state of Maryland, it was a pleasure reading the market study of the Board's consultants. Your work will help many other states as they consider these important, but very complex, issues.

However, it would be a mistake to convert this excellent market and feasibility study into a final program design without further work – and a greater mistake to do so by freezing that program design into law. I hope that, rather than doing so, California will enact legislation establishing requirements both for employers to offer retirement savings and also requirements for the California program, but leave the details of the program within those requirements to the judgment of the Board. An outline of such legislation is provided at the end of these comments.

Should Investment Options for 6,000,000+ Californians be Frozen into Law?

The consultants have reviewed some, though certainly not all, investment options. They recommended two for immediate implementation, a target date fund or a pooled individual retirement account (IRA). They also recommended one for future implementation (a variable annuity with guaranteed withdrawal income), and one for consideration for future implementation (a multiple employer version of a 401k, sometimes referred to as a "MEP").



The consultants recommended two approaches for immediate implementation. Both are feasible, but there are many more.

- *Target date funds* are already well-established and the regulations governing them are understood. Their shortcomings are also well-understood: they offer virtually no protection against market crashes. A person retiring with a target date fund in 2009 would have found their "nest egg" already broken and their retirement future uncertain.

*** Hon. Joshua Gotbaum is a Guest Scholar in Economic Studies at The Brookings Institution. He is a member of the Maryland legislative commission on retirement security. From 2010-2014 he was Director (CEO) of the Pension Benefit Guaranty Corp. These are his personal views.**

The Brookings Institution's commitment to independence precludes taking institutional positions on issues. These comments represent my personal views and should not be interpreted as reflecting the views of Brookings, its employees, officers, and/or trustees, or its other scholars. Neither should they be interpreted as representing the views of the Maryland commission, its staff or its other members or of the Maryland legislature.

- The *pooled IRA* is the better alternative of the two. It is a thoughtful and creative way, authorized by SB1234[1], to provide a cushion against market crashes without putting California on the hook. As the consultant report makes clear, the creation of a reserve in good years will ultimately enable the offsetting of losses during market downturns.[2]

Comments have been solicited as to which option the Board should recommend and the State of California should legislate. If the legislation authorizing a Secure Choice program is limited to only one approach of the dozens that are possible, ***the pooled IRA would be the better of the two – but there's absolutely no reason to preclude alternative designs that likely would better fulfill the Board's mandate by freezing the program design into the enabling legislation.***

I recommend that the State keeps its options open and not make the mistake of other jurisdictions (including the federal government) of putting all the eggs in one basket and hoping it's the right one.

Although the pooled IRA is preferable, neither of the two recommended approaches actually fulfills the Board's mandate under SB1234

SB1234 set standards for California's Secure Choice program that included some of the best features of traditional pensions (while making it clear that California would not accept the liabilities of such pensions). Among these were:

- ***Protecting Retirees' Savings Against Market Crashes*** Section 100013 of SB1234 requires the board to "ensure that an insurance, annuity, or other funding mechanism is in place at all times that protects the value of individuals' accounts." The pooled IRA approach was recommended to achieve part of this requirement, but only part.
- ***Permitting voluntary employer contributions.***[3] While many small businesses cannot afford to add the costs of a retirement contribution, some can and would do so if it were part of the Secure Choice program and didn't involve extra regulations, filings, and administrative hassle. Unfortunately, the payroll deduction IRAs that the consultants focused on don't permit such contributions -- but there are other program designs that would.
- ***Guaranteed income for life.*** Since people are living longer but have no way of knowing how long they will live, most people with retirement savings accounts have no lifetime income except Social Security. They and their spouses are at great risk of simply running out of retirement savings – at an age when going back to work just isn't possible.

The consultants recognized that their own recommendations failed to meet all the provisions of SB1234. They noted that other approaches could achieve them, but declined to recommend those approaches for anything other than possible future implementation. They noted that *voluntary employer contributions could be achieved with a 401k* (a multiple employer 401k plan, or "MEP"). 401k plans also

[1] Section 100006 of SB1234 authorizes, but does not require, the Board to establish a "Gain and Loss Reserve Account" that would be used when market returns fall below projections.

[2] The head of retirement programs for Legg Mason, Gary Kleinschmidt, supports the pooled IRA as the better of those two approaches because it offers an "…opportunity to protect workers who may retire during a stock market decline."

[3] Section 100012(k)

offer other benefits, such as wider array of options and tax credits to offset the cost of implementation. They also noted that *achieving guaranteed lifetime income is possible using a variable annuity w guaranteed minimum withdrawal benefit* and recommended that, but only for possible future implementation.

There are other possibilities beyond those mentioned by the consultants. For example, employer contributions could be possible if a SIMPLE IRA were part of the Secure Choice offering.

Options are available today that weren't when SB1234 was enacted.

The original Secure Choice proposal envisioned the state sponsoring a pooled investment, variable (but defined) benefit open to all employers in California. However, when California enacted SB 1234 in 2012, the legislation was limited to creation of a program of individual retirement accounts (IRAs), largely because any other kind of program would come under the federal Employee Retirement Income Security Act (ERISA): Small businesses were entirely unwilling to become fiduciaries by sponsoring an ERISA plan and the US Department of Labor said at the time that any ERISA-based program would be pre-empted and void by federal law.

The consultant market/feasibility study understandably limited itself to IRAs. It concludes that there will be adequate market demand to support a Secure Choice program and that several IRA designs could be practically and legally feasible. These findings are required by SB1234, but the consultant report went beyond that mandate to recommend a specific program design and only two possible forms of IRA.

Since 2012, however, the US Department of Labor (DOL) reversed its previous guidance:

- DOL has now modified ERISA requirements to allow California & other states to establish Secure Choice 401k's.[4] Corporate 401k's are widely regarded as offering superior options and lower fees than IRAs. They also permit voluntary employer contributions.
- The US DOL also has proposed a regulation that would provide a safe harbor for state-created IRA programs and has solicited comments on ways to improve its efforts.

As a result, California (and other states) now has a broader range of options than it did in 2012. Some of those options could better meet the objectives of SB1234.

Groups opposing a Secure Choice program point out that the regulatory environment is changing. They are right, but that's not an argument against authorizing a program – it's an argument against getting too specific about the specifics of a program, lest regulatory developments change the playing field. The Board, in its submission to the US Department of Labor, requested a series of changes to enable greater coverage and provide greater confidence in Secure Choice's legality. Others have made

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[4] These would be a type of multiple employer plans, or "MEP", which are authorized under ERISA.

While California could not require participation in an ERISA plan, it could require establishment by employers of an opportunity to participate in some kind of retirement savings plan. One means of satisfying that requirement could be participation in a state-sponsored 401k. Under the 9th Circuit decision in *Golden Gate Restaurant Assn. vs. City & County of San Francisco*, the requirement would not be pre-empted so long as there were other means of complying, such as establishment of a private IRA program (of which many are available).

similar suggestions to broaden the applicability of the MEP 401k. It would be a shame for California to enact legislation this spring only to find that other IRA or 401k options are available and could be implemented within the program deadlines.

One Way Programs Fail is When Enabling Legislation is Too Specific

My reasons for suggesting flexibility come in part from personal experience: I've designed and launched large governmental programs. For example, in the 1990's, under the leadership of then-Secretary of Defense William Perry, I proposed & negotiated legislation allowing the Department of Defense to use private capital to refurbish military family housing and then established an office within DOD to implement the program. There had been multiple attempts to do this since the 1950's: each failed because the legislation was too restricted, and the initial efforts couldn't be modified to work effectively. Learning from this mistake, we recommended to the US Congress that they authorize a range of authorities. Congress did so and the flexibility paid off: virtually all military family housing in America, some 200,000 homes, have since been built or refurbished.

Unfortunately, flexibility has not been the hallmark of retirement legislation. The history of retirement legislation is riddled with examples where well-intentioned legislated limitations turned potentially good ideas into also-rans. In the 1990's, for example, companies that wanted to preserve some of the benefits of defined benefit pensions began considering hybrid designs such as cash balance plans. However, legislation "enabling" such plans ended up imposing so many requirements that many companies instead chose to abandon DB pensions entirely and switch to 401k's.[5]

To Get the Most Out of California Secure Choice, Set Requirements & Let the Board Determine How Best to Meet Them.

To date, the California Secure Choice Retirement Savings Investment Board and its consultants have done an admirable job with limited resources. Once it is clear that there will be a program and that it will involve millions of people and tens of billions of dollars, both service providers and investment firms will compete to expand your options beyond those that your consultants were able to considered. They will also "sharpen their pencils" and enable the Board to consider its options with both more and reliable information about costs and fees.

[5] Another sad example was federal legislation intended to protect workers' rights to lump sum payments. It ended up encouraging companies to use lump sums to get out of their pensions. Both the US Treasury and DOL were disturbed by these developments, but didn't feel they could make changes without legislation. This fiasco is described a Brookings summary of 2015 actions affecting retirement.

For all these reasons, I hope the Board will consider recommending to the State legislation that sets the requirements for the Secure Choice program, but allows the Board to exercise its judgment on the details. Such legislation might provide:

- A requirement for businesses that don't otherwise a retirement savings opportunity to do so. This requirement would not apply to any business that lacked an automated payroll processing system.[6] Businesses could satisfy the requirement via the many privately-available IRAs or participation in the California Secure Choice program.
- Establishment by the Board of a default program option and such additional options as it considers appropriate to improve the retirement security of Californians[7], subject to the following requirements:
  - No liability, contingent or otherwise, to the taxpayers and State of California;
  - Compliance with all applicable federal laws -- both tax and ERISA -- and state laws;
  - Implementation of a working program by a fixed date (e.g., two years after enactment)

With such legislation, California would build on the record it has established for thoughtful action, and may very possibly establish a model that can be adopted nationwide.

Joshua Gotbaum
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JoshuaGotbaum@gmail.com
202-797-6498

[6] The reason for exempting businesses on the basis of not having an electronic and automated payroll processing system, rather than on the basis of the number of employees, is to expand retirement coverage while minimizing the burden on small businesses.

[7] These comments focus only on the issue of whether the State of California should decide *now* and freeze into legislation what investment approaches should be available under California's Secure Choice program. However, many of the same issues are presented in determining the default contribution rate and other aspects of program design. Those issues, too, are probably better left to the Board for determination, so that the Board will not have to wait for legislation to improve program designs.

Labor Coalition
Representing Over One Million Labor Union Members in California

American Federation of State, County & Municipal Employees
California Association of Professional Scientists
California Association of Psychiatric Technicians
California Community College Independents
California Correctional Peace Officers Association
CDF Firefighters
California Faculty Association
California Federation of Teachers
California-Nevada Conference of Operating Engineers
California Professional Firefighters
California School Employees Association
California State Employees Association
California State Firefighters Association
California Teachers Association
Faculty Association of California Community Colleges
Glendale City Employees Association
LIUNA Local 777
LIUNA Local 792
Orange County Employees Association
Organization of SMUD Employees
Peace Officers Research Association of California
Professional Engineers in California Government
Public Employees Local #1
San Bernardino Public Employees Association
San Diego County Court Employees Association
San Luis Obispo County Employees Association
Santa Rosa City Employees Association
SEIU Local 1000
Service Employees International Union, California State Council
State Coalition of Probation Organizations
Union of American Physicians & Dentists

March 9, 2016

The Honorable John Chiang, Chair
California Secure Choice Retirement Savings Investment Board
915 Capitol Mall, Room 110
Sacramento, California 95814

Re: Secure Choice Position

Dear State Treasurer Chiang:

The Labor Coalition represents over one million public employees across California and includes unions representing police, firefighters, teachers, nurses, classified, city, county and special district employees. We have been, and continue to be, supporters of proposals to insure retirement security for all, and we have supported and assisted in furthering the goals of the California Secure Choice Retirement Savings Investment Board (Secure Choice Board).

In addition to supporting and lobbying for SB 1234 (De León) union leaders have served on and contributed to the Secure Choice efforts. We believe that all workers deserve to retire with dignity and have a major stake and commitment to insuring that the final product of the Secure Choice Board provides high quality options that add value to the retirement security of working class Californians who currently do not receive pensions.

Principles

From the outset of this discussion and during formulation and debate over SB 1234, the Secure Choice study, we have outlined basic principles that must be met. These include:

- The final product cannot be an off-the-shelf 401K style plan, managed by for-profit entities with little oversight, similar to the plans that anti-pension advocates propose for new public employees. These plans have proven to be inadequate as retirement vehicles, place 100% of the risk on workers, do not adequately control fees and place workers in the position of making complicated investment decisions without providing adequate investment education. Requiring low wage, private sector workers to enroll in a plan similar to those proposed by anti-pension advocates is bad public policy and morally wrong.

- The ideal options should include as many attributes of pension plans as possible, including pooling assets, controlling management and administrative long-term costs/fees, hedging against market fluctuations, maximizing returns and providing a predictable income replacement in retirement. While we understand the obstacles to providing defined benefit plans, it is important that defined contribution options contain as many of the benefits and qualities of defined benefit plans as possible. This is even more important given the fact that requiring employer matching contributions is not currently an option.

- Options should provide both security and choice. If there is more than one option, we believe a default option should minimize risk and promote the highest long-term income replacement. We also believe providing options should not be done in such a way that undermines cost-savings achieved by economies of scale.

Option One v. Option Two

The Secure Choice study outlines two choices, a dynamic asset allocation target date investment strategy and a pooled IRA with a reserve fund packaged as a retirement savings bond.

We believe that the option that most closely meets the principles outlined above is option two. Members and staff of the Secure Choice Board have expressed some concerns related to option two. These include anticipated complications related to establishing and communicating with employees on the reserve and federal regulatory constraints, which require action by the Securities and Exchange Commission (SEC).

The report itself indicates that "SB 1234 attempts to replicate the collective risk-sharing aspect of cash balance plans in the DC context with no employer or state-backed guarantee." The *Pooled IRA with Reserve Fund* (option two) was proposed as "one way to implement collective risk pooling and return smoothing based on the Collective 401(k) concept from the Center for American Progress, developed by study team actuary Rowland Davis."

These aspects of option two adhere to the principles outlined in bullet two, characteristics that are not included in option one.

Alternative Options

The tension between options one and two have triggered discussion over the possibility of a third option.

Our perspective is that option one does not meet enough of our principles to be acceptable. It too closely resembles the types of proposals put forward by those who are proposing to eliminate public employee pensions, it does not provide risk sharing or smoothing, and it may or may not include a proprietary investment fund capable of minimizing administrative and management costs/fees.

We are cognizant of the concerns expressed that option two may encounter difficulties related to implementation, SEC clearance and management costs.

We would point out that there are differing professional opinions and that none of these concerns have been definitively concluded. In this respect we believe that the Secure Choice Board should insure that any legislation on this matter allow for further investigation into this option or alternative options that meet the principles outlined, and best benefit the working Californians who currently have no retirement plan at work.

With regard to a third option, we are willing to entertain options that meet certain criteria, including:

1. The option should include a proprietary pooled asset investment fund that minimizes management costs/fees.

2. The option should address risk sharing and smoothing.

3. The option could include some choices, allowing workers to choose a vehicle consistent with their risk tolerance and financial goals, and provide a default option that provides the lowest risk and highest income replacement.

4. The option should provide the maximum possible income replacement.

Public employee organizations are fully committed to the goal and premise of SB 1234 and the Secure Choice Board. We believe all employees should be entitled to retirement with dignity after a career of work. That is why we believe that it is critical that the final product meet the above minimum criteria and principles.

We look forward to working with the California Secure Choice Retirement Savings Investment Board and the Legislature to accomplish this goal.

Sincerely,

Dave Low
Chairman, Labor Coalition

cc: Members, California Secure Choice Retirement Savings Investment Board
Christina Elliott, Acting Director, California Secure Choice Retirement Savings Investment Board
The Honorable Kevin de León, Senate President Pro Tempore, California State Senate
The Honorable Anthony Rendon, Speaker, California State Assembly
The Honorable Richard Pan, M.D., Chair, Senate Public Employment and Retirement Committee
The Honorable Jim Cooper, Chair, Assembly Public Employees, Retirement and Social Security Committee

DL:ct

Dear Treasurer Chiang

Thank you for your leadership in chairing the California Secure Choice Investment Board. The recommendations of the board and the ultimate enactment and implementation of a Secure Choice retirement plan in California are critical to improving retirement security for millions of Californians.

I am responsible for the retirement team at Legg Mason, we are a global financial asset management firm, with more than $650 billion of assets under management. We are committed to being a responsible global citizen and having a meaningful positive impact in the communities in which we operate. This commitment to our communities has resulted in my appointment to the Task Force to Ensure Retirement Security for All Marylanders under former governor Martin O'Malley, and the subsequent legislative task force created by presiding officers in Maryland's General Assembly. We considered the retirement crisis in Maryland and options for addressing it, in some ways following the lead of your Secure Choice Investment Board.

As you are well aware, the nation is in the midst of a retirement security crisis. Nearly 70 million workers have no access to a retirement plan at work, and relatively few of them are saving for retirement on their own. As a result, half of working age households do not own any retirement assets, whether a defined benefit pension, work-sponsored 401(k) or even an IRA.

For these workers, their only source of income will be Social Security benefits. Social Security alone will not provide an adequate income for meeting basic needs, particularly in high cost areas of California. Half of Social Security beneficiaries receive less than $1,300 a month; for low-wage workers the monthly benefits will be much lower.

Therefore, new initiatives such as that being considered in California are critical for the well-being of workers and communities. In this process, it is important that the board consider the investment approaches and program structures that provide the best opportunity for retirement security. As a result, I encourage the board to recommend a pooled investment model with a reserve fund as part of the Secure Choice retirement saving plan. This approach offers both the best opportunity to protect workers who may retire during a stock market decline. The State of California has the opportunity to offer this unique protection to workers approaching retirement age. While deep market downturns are rare, as we saw in 2008 the impacts on the well-being of cohorts with the bad luck of retiring during one of these downturns is devastating.

I recognize that there might be some complexity in explaining this model to investors. Nonetheless, the potential benefits to workers are worth the challenge. Further, I point to Social Security. It is nearly universally supported; and it would be highly unusual to find a worker (or retirement policy expert) who understands the benefit formula.

The pooled investment model would be an important step in the evolution of these state-based retirement savings initiatives. I would also encourage the board to recommend to the legislature that the board be given the authority to implement other approaches to improving retirement security, such as an optional approach that would allow for employer contributions. As the state of the art of state-supported retirement savings plan evolves, California would want to be well-positioned to implement the best models available for workers and employers.

Thank you for your work leading the California Secure Choice Investment Board.

Sincerely,

Gary Kleinschmidt
Head of Retirement Specialists
Legg Mason
215-872-1317

Cc: Governor Brown
President pro Tempore Kevin de León
California Secure Choice Investment Board members

NCLR
NATIONAL COUNCIL OF LA RAZA

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President and CEO

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March 4, 2016

Christina Elliott
Acting Executive Director
California Secure Choice Retirement Savings Investment Board
915 Capitol Mall, Room 110
Sacramento, CA 95814

Re: Comments on Overture Financial Final Report to the California Secure Choice Retirement Savings Investment Board

Dear Ms. Elliott:

The National Council of La Raza (NCLR), the largest national Hispanic civil rights organization in the United States, strongly supports the California Secure Choice Retirement Savings Program, and welcomes the opportunity to provide feedback on the final report prepared by Overture Financial. NCLR has worked to improve opportunities for Hispanics in the United States for nearly 50 years. One of our core areas of work is economic security and retirement readiness. Efforts to increase access to quality retirement savings plans, such as Secure Choice, are crucial to enhancing Latino retirement readiness, as is detailed in NCLR's 2015 report, "Enhancing Latino Retirement Readiness in California.[1]

LATINO RETIREMENT READINESS

While many Americans have difficulty saving for retirement, this difficulty is exacerbated for communities of color. Sixty-two percent of Black and 69% of Hispanic households lack any assets in a retirement account.[2] For those who do save, their account balances are comparatively low: three in four Black households and four in five Latino households aged 25–64 have less than $10,000 in retirement savings, compared to one in two White households.[3]

The difficulty in saving for retirement is the result of a variety of factors, including low access to employer-sponsored retirement plans and lower rates of participation in those plans. Workers of color have less access to retirement savings vehicles compared to Whites: 38% of Latino employees, 54% of Black employees, and 54% of Asian American employees aged 25–64 work for an employer that sponsors a retirement plan, compared to 62% of White employees.[4] Of those workers who have access to an employer-sponsored plan, not all participate, and the 29.7% Latino participation rate falls well below the 53.8% rate for Whites.[5]

Low wages make saving for retirement especially challenging as costs for housing, health care, and education rise and wages continue to stagnate. Forty-two percent of all Latinos earn poverty-level wages, despite having the highest rate of labor force participation among all racial and ethnic groups.[6] Despite earning low wages, studies have shown that Hispanics value saving. A 2014 national Prudential survey of Latino consumers found that "the 'saver' mindset prevails" with Latinos. However, while 53% of Latinos think that saving for retirement is a high priority, near-term financial needs often compete for limited resources.[7]

CALIFORNIA SECURE CHOICE

The implementation of the California Secure Choice Retirement Savings Program can increase retirement savings options for those without access to an employer-sponsored retirement plan in the state. Latino workers make up the largest share of workers who could benefit from California Secure Choice. In 2014, only 29% of Latinos in the state had access to an employer-sponsored retirement plan and only 21% of them participated.[8] The Secure Choice program has the potential to provide access to a retirement plan for the first time to 3.8 million Latinos in California. Latinos represent nearly half of the individuals who work for employers not offering access to a retirement plan. As such, the success of Secure Choice will be tied closely to its ability to reach California's Latino workers. We have reviewed the final report and are pleased to see certain key features recommended for the Secure Choice program design. Specifically, NCLR believes that the following features will be necessary to maximize access and participation in the program for the Latino community:

- **Universality.** Secure Choice could result in near-universal access to employer-facilitated retirement plans in California, if implemented as recommended in the final report. Secure Choice has the potential to cover a significant portion of the Latino workforce because it requires companies with five or more employees to participate. Still, under the statute, the self-employed and those who work for employers with fewer than five employees might not be able to access Secure Choice. As such, we support the recommendation to allow individuals who are self-employed or independent contractors to enroll to expand access to even more individuals.

  Further, immigration status will not affect a worker's ability to access a Secure Choice account. This will maximize the program's reach to the 78% of Latino immigrant workers, legal and undocumented, who lack access to an employer-sponsored retirement plan.

- **Automatic enrollment.** A central feature of Secure Choice is automatic enrollment, which means that workers would participate in and contribute to their Secure Choice account unless they opted out of the program. As with employer-sponsored plans, workers who are automatically enrolled in Secure Choice would also be given investment guidance to reach their personal goals. A vast body of research shows that, in general, people take a passive rather than an active approach to savings and investment, and automatic enrollment can help adjust for this behavior. One study found that auto-enrollment increased plan participation among new hires from 37% to 86%.[9] Low-income employees are even less likely to opt out of retirement plans when they are automatically enrolled.[10] Additionally, in Latino focus groups conducted by NCLR, respondents had favorable attitudes toward auto-enrollment.[11]

- **Default contribution size.** Secure Choice would enhance participation in workplace plans because it has a default contribution level; NCLR recommends a level of approximately 3% of wages. This is the standard amount that automatically enrolled individuals will be required to contribute through payroll deductions. Unlike the Treasury Department's *my*RA, there is no lifetime cap, which is good for Latinos and other workers for whom Secure Choice may be the only retirement savings option available besides Social Security. Automatic contributions also help to keep the overall funding of the system financially viable.

However, NCLR is concerned with the recommendation for a 5% default contribution level. A higher default contribution could lower take-home pay to an intolerable level and dissuade some low-wage earners from participating. In NCLR's focus groups, Latino participants agreed that 3% was a reasonable default and were sensitive to small differences in how much they could set aside each month for retirement savings.[12] While some stakeholders have argued that a 3% default would not result in adequate savings for retirement, an alternative to a higher default contribution is to establish a robust escalation rate, as recommended. That said, NCLR believes that the recommended level of auto-escalation to 10% is too high, and would affect enrollment.

- **Portability.** Secure Choice accounts will be portable—that is, linked to individual workers, not employers—so that workers will keep accounts as they transition between jobs. Portability is essential to helping workers maintain participation in the program. Portability is especially important for Latino workers given their relative youth and their overrepresentation in industries where there is a higher frequency of job change for various reasons. Switching jobs can cause workers to lose track of accounts or cash out instead of rolling over the funds into another retirement account, one form of what experts call "leakage."

  While the goal of portability is favorable from a Latino perspective, the practical aspects need to be worked out by the Secure Choice Board. For instance, the board could consider a recordkeeping entity that helps keep workers' accounts with them as they change jobs. Such a model has been projected to save $1.3 trillion over 10 years in the private 401(k) system.

- **Flexibility of funds.** In an effort to preserve the adequacy of savings in Secure Choice accounts, several stakeholders have urged the Secure Choice Board to prohibit workers from accessing their accounts for any reason other than retirement. However, many Latino workers might opt out of the program if access to their accounts was blocked until retirement. Latinos and Blacks are more likely to take hardship loans or early withdrawals from their 401(k) plans.[13] Lower income and wealth levels are the driving factors for using retirement savings to pay for shorter-term expenses. In NCLR focus groups, Latinos in California expressed a preference for allowing penalty-free access to Secure Choice accounts under certain conditions. The IRS allows for tax-free early distributions from IRAs to pay for health care, higher education, and the purchase of a first home.[14]

- **Simplicity and customer service.** For a significant share of Latinos, Secure Choice could be the safest savings vehicle they own—or the only one. On a national level, 17.9% of Latino households do not own a bank account.[15] In a limited survey of clients served by nonprofit community-based organizations in the NCLR Affiliate Network, more than one in five (21%) Latinos cited barriers such as fees, identification requirements, and language as reasons for not having bank accounts. Many difficulties associated with establishing and maintaining other accounts will need to be addressed to ensure a successful rollout of Secure Choice.

Focus group participants with employer-based plans expressed exasperation about the complexity of those plans. If participants consider Secure Choice overly complex and do not receive necessary customer support, there is a risk that they will opt out or fail to contribute adequately over time.[16]

- **Perception of the individual.** How workers perceive Secure Choice's benefits can influence their decision to retain their savings instead of opting out, cashing out, or making early withdrawals, thus helping them build adequate savings. The Secure Choice Board has considered features that would incentivize long-term participation in the plan, including principal protection and a guaranteed rate of return. In NCLR focus groups, Latinos understood the value of these features but were more interested in their personal control over the final sum in a savings account based on how much they contribute and for how long. While it is essential that workers understand how their account balance measures up to what they will actually need for a secure retirement, it is also important to motivate participants by portraying Secure Choice as a future stream of income, rather than a slowly accumulating savings account.[17]

CONCLUSION

As the retirement crisis looms large, plans such as Secure Choice are a positive step toward enhancing retirement security for Latinos. While not a substitute for urgent reforms needed at the federal level to strengthen Social Security and enhance opportunities for low- and moderate-income workers to save for retirement, state plans nevertheless deserve attention. They represent significant progress in addressing inequities in the employer-based retirement system that disproportionately affect Latinos. By taking into account how Latinos might respond to various plan features, lawmakers in California have a unique opportunity to enhance the retirement security of millions of hardworking individuals while serving as a model for other states. Through state plans and complementary policy solutions, policymakers are positioned to encourage retirement savings and begin reversing longstanding disparities in retirement security.

Thank you again for the opportunity to comment on this report. Should you have any questions regarding these comments, please contact Marisabel Torres at mtorres@nclr.org or (213) 787-9602.

Sincerely,

Eric Rodriguez,
Office of Research, Advocacy and Legislation
National Council of La Raza

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[1] Catherine Singley Harvey, *Enhancing Latino Retirement Readiness in California* (Washington, DC: NCLR, 2015), www.nclr.org/images/uploads/publications/LatinoRetirementReadiness2015.pdf (accessed January 2016).
[2] Nari Rhee, *Race and Retirement Insecurity in the United States* (Washington, DC: National Institute on Retirement Security, 2013), 1,

www.nirsonline.org/storage/nirs/documents/Race%20and%20Retirement%20Insecurity/race_and_retirement_insecurity_final.pdf (accessed January 2016). For previous work on this issue, see Leticia Miranda, *Insecure Retirements: Latino Participation in 401(k) Plans* (Washington, DC: NCLR, 2009), www.nclr.org/images/uploads/publications/file_Latinos_and_401K_plans_Final.pdf.

[3] Ibid.

[4] Ibid.

[5] Nari Rhee, *Race and Retirement*, 3.

[6] Economic Policy Institute, "Share of workers earning poverty-level wages, by race and ethnicity, 1973–2013," http://www.stateofworkingamerica.org/chart/swa-wages-figure-4f-share-workers-earning/ (accessed January 2016).

[7] Prudential Research, The Hispanic American Financial Experience (Newark, NJ: Prudential, 2014), www.prudential.com/media/managed/hispanic_en/prudential_hafe_researchstudy_2014_en.pdf (accessed January 2016).

[8] Catherine Singley Harvey, *Enhancing Latino Retirement Readiness in California* (Washington, DC: NCLR, 2015), www.nclr.org/images/uploads/publications/LatinoRetirementReadiness2015.pdf (accessed January 2016).

[9] Brigitte C. Madrian and Dennis F. Shea, "The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior," *Quarterly Journal of Economics* 116, no. 4 (2001): 1149–1187.

[10] John Beshears et al., *Financial Inertia Among Low-Income Individuals—Plan Carefully When Setting 401(k) Defaults* (Washington, DC: Retirement Made Simpler, February 2013), www.retirementmadesimpler.org/Library/Plain_English_Paper_RMS_NBER_Paper.pdf.

[11] Catherine Singley Harvey, *Enhancing Latino Retirement Readiness in California* (Washington, DC: NCLR, 2015), www.nclr.org/images/uploads/publications/LatinoRetirementReadiness2015.pdf (accessed February 2016).

[12] Ibid.

[13] Ariel/Hewitt, *401(k) Plans in Living Color*.

[14] Internal Revenue Code, § 72(t)(2)(E) and (F).

[15] Susan Burhouse et al., *2013 FDIC National Survey of Unbanked and Underbanked Households*. Washington, DC, 2014, https://www.fdic.gov/householdsurvey/2013report.pdf.

[16] Strong consumer protections are essential to the success of Secure Choice. In addition to clear and linguistically appropriate disclosures to workers, it will be important that Secure Choice establish a set of criteria to vet the vendors that will manage the investments and the administration of Secure Choice accounts. *Source:* Karen Friedman and Norman Stein, *Retirement Saving Policy: Consumer Protections in State-Sponsored Retirement Plans for Private-Sector Workers* (Washington, DC: AARP Public Policy Institute, 2014), www.aarp.org/content/dam/aarp/ppi/2014-10/spotlight7-consumer-protections-state-sponsored-rp-psw-AARP-ppi-econ-sec.pdf.

[17] Brigitte C. Madrian, "Successful Retirement Plan Communications for Various Population Segments," 113th Cong., 1st sess., 2013, http://www.dol.gov/ebsa/pdf/Harvard082713.pdf.

March 4, 2016

The Honorable John Chiang,
Treasurer and Chair
California Secure Choice Retirement Savings Investment Board
915 Capitol Mall, Room 110
Sacramento, CA 95814

Dear Treasurer Chiang:

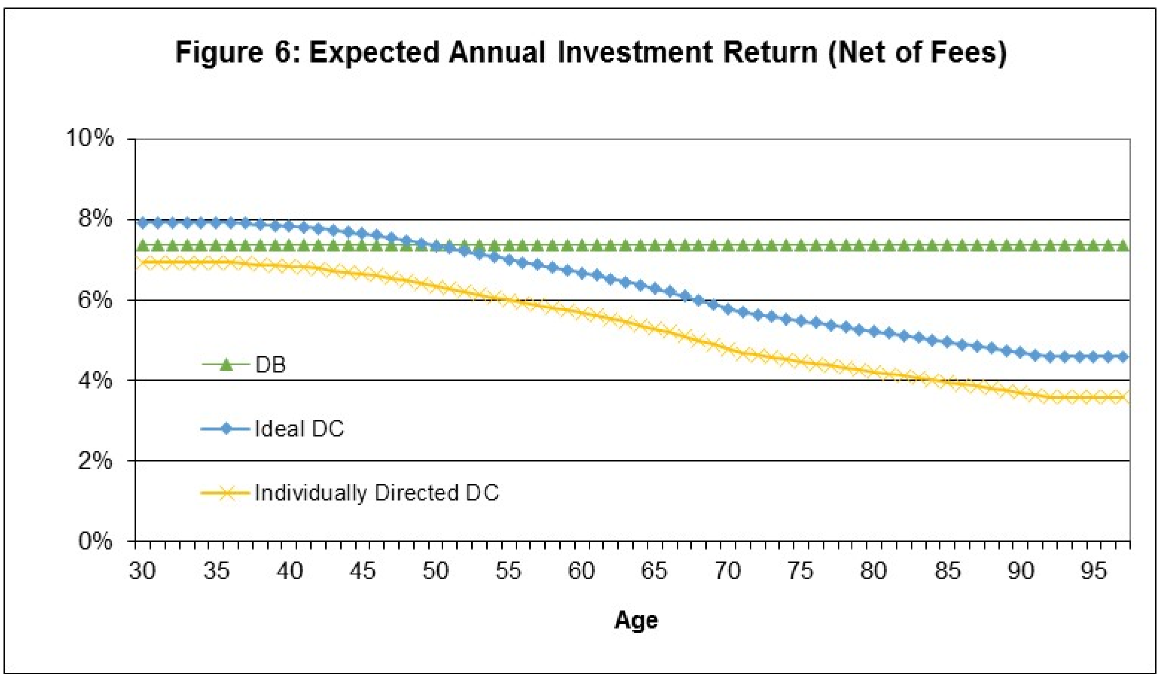
Improving the retirement security of millions of Californians will depend on the recommendations of the California Secure Choice Investment Board to the state legislature. I thank the Board for its careful consideration of these matters. Also I would like to take this opportunity to share some of the research that the National Institute on Retirement Security (NIRS) has done comparing the returns from a pooled funding option with those from retirement accounts invested in target date funds—two options that you are considering.

NIRS is a non-partisan, non-profit research and education organization with a mission to conduct research designed to help ensure a U.S. retirement system that meets the needs of employers, employees, and the nation's economy. NIRS' national and state level research has documented the looming retirement savings crisis and the critical need to expand payroll-based retirement savings opportunities to all Americans through programs like the California Secure Choice plan.

In 2014, NIRS conducted an economic study of the cost efficiencies of providing retirement income through either a pooled fund in a defined benefit (DB) pension plan or target date funds (TDFs) in defined contribution (DC) retirement accounts. That report, *Still a Better Bang for the Buck: Update on the Economic Efficiencies of Pension Plans,* evaluates the economic efficiencies embedded in pooling DB plan assets. Specifically, we found that using a pooled fund that consistently invested assets using an optimal asset allocation delivers an 11 percent advantage over time when compared to individual participants investing their account in target date funds.

During the early years of the California Secure Choice Retirement plan, the most significant increase in the value of participant accounts will come from their ongoing contributions to the plan. The pooling of the California Secure Choice plan assets in a fund that will grow larger each year enables its managers to maintain an optimally balanced investment portfolio from inception and maintain that allocation throughout the working careers and retirements of typical participants. In contrast, isolating each participant's contributions in an individual account using a target date fund (TDF) forces the participant to down shift from a portfolio with high equity allocations when young to a lower risk portfolio of cash and bonds as he or she approaches retirement. This automatic shift in asset allocations of target date funds will sacrifice higher potential investment returns generated from stocks. By design, TDFs deliver lower investment returns when the retirement assets in individual accounts have their greatest value.

The model in *Still a Better Bang for the Buck* estimated gross investment returns for pooled and TDF approaches starting with asset allocations for each and then applying a uniform set of assumptions about the long-term returns for each asset class. Our pooled fund was modeled on the asset allocation typical in a large public sector DB plan. In the TDF approach, we incorporated a gradual shift out of higher risk/higher return assets in favor of lower-risk/lower return assets. We adapted the model's TDF glide path from the asset allocation glide paths of the two largest investment managers offering TDFs: Vanguard and Fidelity.



In the NIRS model, the well-diversified pooled fund's expected investment returns was 7.36 percent per year, net of fees. This return is represented graphically by the

green line, marked "DB" in Figure 6. While the typical TDF asset allocation glide path in our study would earn higher returns than the pooled fund during the first half of a worker's career, those returns drop below a pooled fund's returns when a participant is in his or her late 40's. Figure 6 illustrates these TDF returns by the blue downward sloping line marked "Ideal DC." Once retired, individuals are assumed to reduce their exposure to equities even more. For detailed pooled and TDF asset allocations and projected returns, see Table A1 in the Technical Appendix of *Still a Better Bang for the Buck: Update on the Economic Efficiencies of Pension Plans* at:
http://www.nirsonline.org/storage/nirs/documents/Still%20a%20Better%20Bang/bangforbuck_2014.pdf.

Furthermore, another example of pooled fund option is the TIAA participating annuity, which features a pooled investment fund, establishes reserves for contingencies, and declares dividends annually. Although insurance regulations require TIAA's pooled investment fund to be less diverse than the proposed option, TIAA's dividend policy of distributing unneeded reserves to retirees may suggest an alternative way that early funds diverted from returns to create the desired reserve levels could flow back to those individuals.[1]

While it remains a somewhat complex task to explain the pooled funding approach to participants, TIAA has a nearly 100-year track record demonstrating the benefits of a pooled fund for individuals. While many feel that TDFs simplify the investment selection for individuals saving in retirement accounts, TDFs do not eliminate the risk of significant market drop generating a large drop in individual participants' accounts. Given the generally lower income levels of uncovered workers, data suggest that many may have lower tolerance for investment risk. These participants in the California Secure Choice plan may unknowingly be exposed to greater investment risk in the TDF option than they may realize. Should a major market downturn hit their TDF account, they may react negatively, lowering their future participation.

In any case, the pooled fund approach could serve as an evolutionary step as best practices in administering state-supported retirement savings plans unfold. The California Secure Choice plan could launch a plan with more secure savings and better returns in the long run, while remaining well positioned to implement the best models available for workers and employers.

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[1] B. Goodman and D. Richardson, 2014, "TIAA and CREF: Program Features and Recent Evidence on Performance and Utilization," TIAA Institute, New York, NY
https://www.tiaainstitute.org/public/pdf/rd114a_program_features_recent_evidence.pdf

Thank you for your work leading the California Secure Choice Investment Board.

Sincerely,

Diane Oakley

Diane Oakley, Executive Director

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March 25, 2016

The Honorable John Chiang
California State Treasurer
Chairman, California Secure Choice Retirement Savings Program
915 Capitol Mall, Room 110
Sacramento, CA 95814

RE: Professional Employer Organizations (PEOs) and Administration of the Secure Choice Program.

Dear John:

It was great to run into you in Los Angeles before the Secure Choice hearing. I trust in the interim all with you has been well.

I am writing to you on behalf of my client, Insperity, which is a PEO and a full services human resources and payroll administration firm with an extensive clientele of businesses of all sizes throughout California. At this time, Insperity has no position on the general advisability of proceeding with the Secure Choice Program. As an entity that has extensive experience complying with employment tax and benefit administration programs, however, Insperity would like to offer some very specific comments about a significant element of the Final Report (the Report) currently pending before the Board.

On pages 11 and 104 of the Report, there is a recommendation that the "Party that controls payroll (e.g. temp agency) is responsible for compliance". For the reasons discussed below, Insperity instead feels that the responsibility for compliance should rest with "client employers" (i.e., the worksite employer), at least as it relates to PEOs.

Employers (and Therefore Their Workers) Move In and Out of PEO Relationships, Creating Problems for both the Employer and the Worker.

PEOs like Insperity differ significantly from temporary agencies and so-called "staffing companies". With rare exceptions, PEOs take the existing workforce of a business and during the course of the contractual relationship with the business assume an employment relationship with that business' workers for certain limited purposes, which include payroll administration or health benefits. Unlike temporary or staffing agencies, however, PEOs generally do not engage in recruitment or hiring of new employees in their own name for the purposes of supplementing a client's existing permanent workforce.

Client employers often move in and out of PEO relationships in the course of any given time period. If compliance responsibility (reporting, determination of eligibility, record retention, etc.) were placed at the PEO level, as the Report suggests, not only would compliance tracking be problematic when the client employer leaves the PEO relationship, or engages a different PEO, but unintended negative consequences could be potentially created for the worker as well.

For example, is an employee had opted out of the Secure Choice program when the client employer was not with a PEO, they could easily be unaware of an automatic enrollment feature upon the initiation of a new PEO arrangement. That worker may be surprised by a sudden unanticipated decrease in their paycheck which could make it difficult for them to meet their existing monthly financial obligations.

Finally, compliance and financial responsibility should remain at the client employer level because the client employer controls much of the relevant information to determine client and employee eligibility, including the employee's period of service and hours worked. This issue of control of the relevant information is particularly troublesome with regard to determining the eligibility of part-time or temporary employees.

General Recommendations as an Alternative to the Recommendation in the Final Report.

In lieu of the recommendation in the Report, we would prefer that a PEO's responsibility be limited to making the deductions from the employee's paycheck, crediting them back to the client employer and having the client employer remit them to the state agency. This is current procedure for how Insperity handles situations when the client employer has its own retirement plan and chooses not to involve Insperity with recordkeeping. This also makes sense because if a PEO offers a retirement plan but the client employer chooses not to have that offer extended to its workforce, the client employer should assume the responsibility for compliance with the Secure Choice.

For these reasons, Insperity asks that the Secure Choice Board modify the Report to place the compliance responsibility on the client employer where a PEO relationship is involved. We have additional observations for your consideration, set forth below:

Other Recommendations

- Remittance of payroll deductions to a third party (state agency or state-designated recordkeeper)
  - Preferably, client employers would be responsible to remit deductions to the IRA/trust. Many PEOs may not have the ability to remit funds directly to multiple recordkeepers, and there are significant concerns on how the funds would be remitted. The responsibility for failure to remit funds should rest with the client employer, not the PEO.
  - If PEOs are to be responsible to remit the funds, there should be a single location/recordkeeper for all remittances. Otherwise, a PEO with hundreds

of clients could have extensive time and financial impact to remit to multiple different locations.

- If an employee can designate a variety of IRA custodians, then the client employer remitting the contributions should be entitled to rely upon the employee's direction and be relieved of liability for any delayed or improper account establishments, investment delays or other similar events beyond the employer's control.
- A standardized format for file feeds should be developed with recordkeepers to ease the remittance process, and restrictions should be implemented to prevent unilateral file format changes by recordkeepers without adequate notice to implement any changes.
- Regardless of who is responsible to remit funds, there should be a specified safe harbor time period to remit funds without penalties after they are withheld. This period should correspond with the Department of Labor Safe Harbor rule for small plans as outlined under 29 CFR § 2510.3-102(a)(2).

- Additional Compliance Issues

    - Determination of "eligible employers" should be based on the size and location of the client (not based on size or location of the PEO).
    - Clients that provide their employees with access to an employer sponsored 401k plan (either sponsored by the PEO or by the client) should be treated as having provided an offer of an employer sponsored plan to their employees.

We appreciate the opportunity to present our views on the Final Report to you and the Commission. Please feel free to contact me at the above numbers if I can provide additional information about our position on this matter.

Sincerely,

Eric J. Miethke

EJM/vb

cc: Ms. Christina Elliott
Acting Director, CA Secure Choice Retirement Savings Board
915 Capitol Mall, Room 110
Sacramento, CA 95814

OVERTURE™
FINANCIAL

Date: March 10, 2016

To: Honorable John Chiang, California State Treasurer

From: Mohammad Baki, Overture Financial
Nari Rhee, UC Berkeley Center for Labor Research & Education
Rowland Davis

Re: Response to Controller Betty Yee's Questions about the Pooled IRA Option

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Please find below our responses to the questions posed by Controller Betty Yee to the Treasurer and the California Secure Choice Retirement Savings Investment Board in the letter dated March 7, 2016, regarding the costs associated with the Target Date investment strategy and the Pooled IRA with Reserve Fund. The Controller's letter refers to a Target Risk Fund, but Option 1 in the final report is a Target Date strategy implemented through either managed accounts or mutual funds (Target Date Funds or TDFs). For the sake of simplicity, we refer to Option 1 as the TDF in our responses below.

We have included the Controller's questions verbatim in bold text followed by our responses. Please let us know if you have any further questions.

1. **Some of the most important assumptions for both the Target Risk Fund and the Pooled IRA option, include:**

    - **Median long-term inflation rate of 2.5%**
    - **Wage inflation of 0.5% (adjusted for inflation)**
    - **Estimated U.S. bond compound return is 4.5% and for equities 7.9%.**
    - **Ten Year Treasury Note – 4.25%.**

    Why is the 4.25% rate being used when the 10-year Treasury rate is currently 1.84% and the 10-year Treasury rate has not exceeded 4.25% since 2007?

Response: Most capital market assumptions in the pension industry assume a reversion to historic interest rates over the long term, as the Federal Reserve returns slowly to normal monetary policy after the prolonged intervention following the Great Recession. We used these assumptions to project long-term investment returns.

In addition to the low Treasury rates, the three-year fixed income returns at both CalPERS and CalSTRS have been under 2.5%. What happens to participants' deposits if the assumptions are not met?

Response: To begin, fixed income investments make up a small portion of the Pooled IRA portfolio that we modeled, which we designed to be equivalent in risk to a TDF over a full career. An exception is the initial phase-in period. For the TDF investment strategy, we recommend that participants be defaulted into a low-risk vehicle such as a Stable Value Fund, Treasuries[1], or money market fund for the first three years. For the Pooled IRA, we recommend an 80% bonds/20% stocks allocation for the first three years. During these initial years, participant account balances will simply experience low investment earnings and low volatility.

More importantly with respect to long-term outcomes, <u>our retirement benefit forecasting model already accounts for potential variation in portfolio returns and provides high and low outcomes in addition to the expected outcome.</u> We used a statistical probability distribution around the mean values listed above to project the 5th percentile, 50th percentile, and 95th percentile income replacement rates for participants. These results were presented in several Board meetings, including on August 24, 2015. For the first generation in the Pooled IRA, we project an average income replacement rate of 22.4%, with a range of 12.3% to 44.2%.[2]

If short- and long-term portfolio returns fall well short of the projected mean, Pooled IRA participants will ultimately earn lower returns, but on average will not be worse off than TDF participants. Indeed, in scenarios where there are far more negative return years than expected, reserves will be exhausted, and participants will generally end up with the same outcomes as if they had been in a conventional balanced fund with the an asset allocation profile that is similar in long-term risk to the TDF that we modeled.

If wage inflation does not hit the assumed 0.5% do you expect participants to stop contributing?

[1] The Treasury instrument underlying the MyRA product, if made available to California Secure Choice, could offer higher returns than a money market fund.

[2] These represent the range of statistically likely market conditions in a single 42-year period. The distribution of probable income replacement outcomes for successive retirement cohorts, over time, will be narrower for the Pooled IRA than the TDF successive cohorts, given the former's smoothing feature.

Response: We do not assume that participants will stop contributing if wage inflation does not meet expectations. A greater risk is that if there is another major recession, some participants will be tempted to withdraw their funds prematurely.

2. **On page 87 of the Report, Overture notes one of the trade-offs of the Pooled IRA, is in the early start-up years, some of the available returns will be diverted towards establishing the desired reserve level, and credits will not "flow" to participants.**

   What impact will this have on participation? Was this clearly explained to and asked of the market study participants? What if the reserve does not accrue as hoped during the first few years? Should there be strong provisions to protect the Board from pressure from participants to credit accounts or increase credits over time?

Response: We do not anticipate a significant impact on participation. The market study only provided basic details about the program to participants and did not distinguish between investment options, except as a test for how participants weigh the risk/reward tradefoff. Since the difference in probable outcomes differs little between the first generation of Pooled IRA participants and the Target Date strategy, we do not anticipate that this will impact participation. There is little or no evidence in behavioral finance research to indicate that such small differences in likely outcomes—for instance, arising from the specific asset allocation glidepath of the default TDF series offered by an employer-sponsored 401(k)—have an effect on opt-out rates.

At the same time, we note strong recommendation from the worker centers and community based organizations that we interviewed that Program education should focus on informing participants about the basic workings of the program and their rights under the law, rather than a deep dive into investment related issues that can be overwhelming. Participants should be given the opportunity to learn more, if they so desire, through an accessible source such as a web page.

During the first few years, in order to protect against a large market shock as participants are getting accustomed to saving, we recommend that the program invest in a conservative portfolio of 80% bonds and 20% stocks (see page 85 of the Final Report, under "Plan Policy"). This is consistent with our recommendation of a low-risk investment for the first three years if the Program is legally allowed to implement the Target Date investment strategy through Managed Accounts. Furthermore, if the reserves do not accrue as hoped, this means that earnings were not diverted into the reserves, but fully credited to participants. Thus participants do not lose anything if fund returns are insufficient to build a reserve. This holds true even if the fund has to reduce account balances due to an ill-timed, large market shock—participants are no worse off than they would have been if they had borne investment risk individually.

We highly recommend that the Board set an iron-clad set of crediting rules at the outset so that they cannot give into pressure to stray from this policy. (The real cause for concern here is not that insufficient reserves will accrue, but that as the reserve grows, there will be pressure to prematurely award excess credits to participants in a way that is inconsistent with Program policy and compromises its long-term capacity to protect participants against market timing risks.) The Board should consider whether this is best accomplished through statute or governmental regulations.

How would the Board address the equity issue with the first generation of participants who will pass on a share of their returns to the reserve fund? Is there a mechanism to make them whole when the Reserve hits a certain point?

Response: It is important to understand that most of the redistribution through the Reserve Fund will happen across market cycles (such as the late 1990s bubble and subsequent collapse in 2000/2001) rather than across generations, with the effect of evening out sharp differences in retirement incomes based on market timing. Moreover, if the Reserve exceeds a certain level--40% of aggregate account values in our model—the excess value above that level is incrementally credited back to participants.

Nonetheless, there is indeed a statistical likelihood of some transfer of returns from initial participants to later participants. We believe that this is mitigated in large part by the value of a "smooth ride" for even the first generation of participants, akin to a much more expensive annuity product—albeit without the contractual guarantee—and the fact that the sacrifice in returns compared to what participants would earn in a TDF is rather small. The average expected replacement rate of 22.4% for the first generation in the Pooled IRA is only slightly lower than the 24.2% expected from the TDF.

3. The Pooled IRA fund option has never been implemented. Yet clearly this option entails Board fiduciary duties analogous to board duties at CalPERS and CalSTRS, with respect to investment policy and allocation decisions:

Response: While the fiduciary duties may be more substantial with the Pooled IRA than with a TDF, we believe that the Board's fiduciary duties with respect to the Pooled IRA will be far below the level exercised by the CalSTRS and CalPERS boards, for reasons explained below.

Traditional defined benefit (DB) plans have to solve for liabilities arising from contractually promised lifetime benefits based on final salary and years of service. This entails a complex set of calculations involving expected returns and discount rates based on asset allocation, and actuarial assumptions regarding workforce turnover, tenure, longevity, and pensionable pay. In traditional DB plans, asset allocation ultimately functions as a lever with which to balance plan cost and financial risk to the plan sponsor. Even in a cash balance DB plan, the sponsor is explicitly liable for promised benefits—expressed in lump sum rather than retirement income terms—and makes asset allocation decisions accordingly.

In contrast, the Pooled IRA involves making an initial decision to set the asset allocation policy and then establishing and following fixed rules by which to: credit participants <u>past</u> investment returns on their contributions, set aside reserves, and allocate credits from the reserve when investment returns are poor. Unlike a DB plan, there is no financial risk or liability to the plan sponsor for participant benefits under a Pooled IRA arrangement.

Fundamentally, the Pooled IRA is a defined contribution (DC) plan in which benefits are ultimately contingent on employee contributions and investment returns. The main difference between the Pooled IRA and a conventional DC plan is that investment returns are somewhat smoothed over time and across cohorts of participants, rather than purely individualized according to market timing.

<u>While the Board needs to exercise discretion with respect to Pooled IRA asset allocation policy, the level of fiduciary burden here is not dissimilar to the one that the Board would face in setting the default risk level for a default Target Date investment strategy</u>. It should be stressed that even if the Board were to choose an off-the-shelf mutual fund, the Board would still retain fiduciary responsibility over asset allocation by virtue of the fact that participants are being defaulted into the fund.

If the Pooled IRA option is selected, what would be the estimated cost to hire a consultant to conduct the asset allocation study? Assuming this work would continue throughout the life of this program, should this cost be projected annually?

Response: <u>The Pooled IRA should not entail substantially more monitoring of asset allocation than a Target Date investment strategy</u>. In both cases, the Board should review capital market assumptions and perhaps fine-tune the asset allocation from time to time, with the aid of an investment consultant and actuary. In addition, the Pooled IRA involves monitoring a single fund, as opposed to multiple funds in a TDF series. <u>Therefore, there should be no difference in consulting costs across the two approaches.</u>

Before the program launches, however, some extra actuarial work will be required to ensure that the Pooled IRA crediting policy is well-calibrated to its investment policy. For instance, if the Board chooses to implement a less risky portfolio than the one we modeled in our study, the actuarial consultant should model outcomes to ascertain whether the crediting rate policy should also be adjusted. This work adds an incremental layer of complexity to the standard Monte Carlo simulations that should be run for any California Secure Choice default investment product.

In our study we have budgeted US $350,000 for investment consultants in the first year of operation and $250,000 thereafter, for both the TDF and the Pooled IRA options. In the case of the TDF, the incremental US $100,000 in the first year would go towards fine-tuning glidepaths and product creation and selection. In the case of the Pooled IRA, the same amount would go towards actuarial analysis and establishing the crediting policy. The annually recurring US $250,000 covers standard investment consulting activities such monitoring investments and reviewing the investment policy.

Given the pooled nature of the investment program for the Pooled IRA, would the Board incur additional ongoing (annual) consultant costs analogous to those incurred by the State's pension funds to oversee and help inform the Board of investment performance, investment options, and any legislative directives on divestment?

Response: <u>The short answer is no, but this requires action by the Board to insulate its investment policy regardless of whether the default investment is a TDF or Pooled IRA.</u> The Pooled IRA is still a DC plan. Moreover, and investments are pooled in both the TDF and Pooled IRA options. Insofar as the innovative feature of shared investment risk among participants distinguishes the Pooled IRA from a typical DC product, it behooves the Board to carefully delineate its investment policy in a way that insulates it from the kinds of political demands and related costs faced by CalSTRS and CalPERS, and in a manner that parallels the responsibilities of California Savings Plus in managing its proprietary mutual funds for state employees.

<u>Ultimately, we highly recommend setting an investment policy that relies extensively on passive investment strategies. This recommendation applies whether the Board chooses a Target Date investment strategy or the Pooled IRA option, or a custom fund series versus an off-the-shelf fund series.</u> In general, we discourage the Program from engaging in the kind of active investment management practiced by state pension plans. However, we note that for certain asset classes—small cap equities and emerging market equities—active management may produce superior returns. These asset classes may make up approximately 10% of the California Secure Choice portfolio, and the Board should carefully weigh the potential cost of opening up the door to political influence on investment policy against the benefits of active management for these asset classes.

<u>The Board should seriously consider whether codifying a passive management approach in statute or in governmental regulations will help alleviate its investment management burden</u> and, importantly, insulate its investment policy from political influence—and make recommendations to the Legislature accordingly.

Lastly, I would greatly appreciate an estimated cost comparison of the likely annual consultant, fiduciary counsel, and investment management fees, broken out by service provided, of a pooled program, so all of the costs of the pooled IRA option are identified clearly.

Response: We broke down and explained the annual consultant budget in the last paragraph of the second response under Question 3 above.

With regard to counsel and legal fees, we have budgeted for the second year of operation and thereafter a recurring US $250,000 in external legal fees, in line with the California Savings Plus budget. Additionally, the cost of in-house legal counsel is built into the internal staff budget. For the first year of operation, we have budgeted US $500,000 of external legal services in the case of the Target Date investment strategy and an additional US $1 million for Pooled IRA option. The higher cost of the Pooled IRA option relates to the creation or adaptation of the special purpose legal entity and the issuance of the Secure Choice bonds.

As far as investment management fees are concerned, we have budgeted 18 bps on assets under management. The fees for both options should be comparable because assets are pooled in both cases. Furthermore, given the expected size of the asset base (e.g., US $1.6 billion in year 1) and the likely reliance on passive investment strategies for a significant part of the investment portfolios, the low fees that we have budgeted are attainable.

OVERTURE™
FINANCIAL

Date: March 23, 2016

To: California Secure Choice Retirement Savings Investment Board

From: Nari Rhee, UC Berkeley Center for Labor Research & Education
Mohammad Baki, Overture Financial

Re: Response to Selected Public Comments Regarding the Financial Feasibility and Market Analysis Studies Conducted for California Secure Choice.

Several concerns regarding our Financial Feasibility Study and the Market Analysis were raised during public hearings and in comment letters to the Board. This letter provides several points of clarification regarding our methodology—including key assumptions—as well as factual correction regarding some misinterpretations of our Market Analysis findings. There were many other comments which we do not have time to respond to in writing, but would be happy to address if the Board wishes.

Our responses to key concerns gleaned from public comments follow. Highlights from our responses include the following:

- A 5% default contribution rate can be safely assumed to yield a 5% effective contribution rate, based on robust empirical data and data from our Online Survey.
- Our model is highly conservative in its key assumptions. The baseline model already assumes a 40-43% effective opt-out rate, when all factors are taken into account—below that of most voluntary/opt-in retirement plans. It also under-estimates participant incomes compared to current levels.
- A large majority of Program costs will consist of per-employee and per-employer unit costs to service accounts and process payroll deduction contributions. Thus even if a significant share of employers (especially large employers) were to peel away, the Program would still be self-sustaining.
- Contrary to some observations based on a misreading of selected statistics from our Online Survey of eligible workers, the actual survey findings support the need for an automatic retirement savings plan and indicate that a large majority of eligible workers want to take advantage of California Secure Choice. These findings are validated by a large body of existing empirical research.

1. The baseline feasibility model assumes a 5% default contribution rate. Shouldn't there be accounting for a significant share of employees choosing a lower contribution rate?

The joint letter for Association of California Life and Health Insurance Companies (ACLHIC) and American Council of Life Insurers (ACLI)[1] raise the concern that our financial feasibility model did not account for a significant share of participants electing lower contribution rates than the default, thereby generating significantly lower contributions than are projected by the model.

Our assumption that a 5% default contribution rate leads to an average contribution rate of 5% of covered payroll is conservative, in light of empirical data and our internal survey findings related to participant behavior in auto-enrollment plans.

Furthermore, the Feasibility Study includes analysis of an alternate scenario with a 3% default contribution rate, which still supports Program self-sufficiency, albeit with a longer time-frame and a larger startup loan.

Our Online Survey of 1,000 California workers eligible for the Program, conducted as part of the Market Analysis study, included a behavioral experiment to gauge potential opt-out rates and contribution rate elections in response to two different default contribution rate scenarios: 3% and 5%. We found no statistically significant difference in opt-out rates between the 3% and 5% scenarios. We also found that high-income workers are less likely than low-income workers to opt out (21% for $60,000+ vs 29% for less than $30,000 personal income).[2]

In terms of likely contribution rates among participating workers, both our Online Survey findings and existing empirical data on auto-enrollment support the conclusion that a 5% default contribution rate leads to an average deferral rate that is higher than 5%:

- In our Online Survey scenario with the 5% default contribution rate, one out of five respondents said they would stay in the program but choose a different contribution rate. Of this group, more than half (55%) chose a higher contribution rate than the default. High-income workers were particularly likely to choose a higher contribution rate.

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[1] ACLHIC & ACLI, Letter to The Honorable John Chiang, California State Treasurer, March 10, 2016.

[2] Likewise, the Vanguard Group found that participation rates in auto-enrollment 401(k)s increased by income, from 87% among workers making less than $30,000 a year, to 94% among those making more than $75,000. At the same time, auto-enrollment caused the most dramatic increase in participation among workers making less than $30,000 a year, only 22% of whom participated in opt-in plans. Robinson, op cit.; Jeffrey W. Clark, Stephen P. Utkus, Jean A. Young, "Automatic Enrollment: The Power of the Default," Vanguard Research, January 2015. https://pressroom.vanguard.com/content/nonindexed/Automatic_enrollment_power_of_default_1.15.2015.pdf.

- T. Rowe Price found that in their auto-enrollment 401(k) plans with a default 5% contribution rate, 52.6% contribute at the default rate, 35.7% contribute more than the default, and only 11.8% contribute less than the default.[3]

- The Vanguard Group, the largest manager of 401(k) assets in the US, found that average contribution rates among participants increased over time in auto-enrollment plans with no auto-escalation—though to a lesser extent than in plans with auto-escalation.[4]

- Behavioral finance studies on 401(k) auto-enrollment have also found that with modest default contribution rates, participants are more likely to choose a higher contribution rate than a lower one, and contribution rates increase over time, even with no employer match.[5]

In summary, higher-income workers are more likely to participate than lower income workers; and participating workers are more likely to choose a higher deferral rate than a lower deferral rate compared to the default. In light of these facts, our financial feasibility modeling was conservative in its assumption that average deferral rates (as a percentage of participants' pay) would stay at 5% and not increase over time.

2. What if the Program does not realize key assumptions of the financial feasibility study?

As we explain below, our model and assumptions have additional measures built in that make them significantly more conservative than the explicit assumptions indicate. In addition, the cost structure of the Program will be such that its financial feasibility is much less sensitive to employer and employee participation rates than some believe.

A. 25% opt out rate in the baseline model.

In reality, the effective opt out rate in our baseline model is 40-43% compared to the current eligible population. This translates into participation estimates that are below those for a voluntary/opt-in plan.

The participant-driven opt-out rate (percentage of employees who actively choose not to participate) is just one component of the employee participation estimates in our model, which incorporate other conservative measures.

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[3] Mark Robinson, "Success of Auto Enrollment and Auto Increase: Using Behavioral Finance to Improve Retirement Planning," Presented at EBRI Policy Forum, May 13, 2010. https://www.ebri.org/pdf/programs/policyforums/Robinson0510PF.pdf.
[4] Clark, Utkus & Young, op cit.
[5] See James Choi, David Laibson, Brigitte C. Madrian, and Andrew Metrick, "Saving for Retirement on the Path of Least Resistance," National Bureau of Economic Research, July 2004.

- We assume an additional 10% reduction in anticipation of Social Security number match problems.
- We also assume a significantly smaller eligible population than is likely: 6.3 million based on employment levels during the last recession. The current number of private employees age 18-64 without access to an employer-sponsored retirement plan is 6.8 million based on a 3-year average from 2012-2014, and 7.2 million based on 2014, according to data from the Bureau of Labor Statistics.
- This means that in the baseline scenario which assumes a 25% employee opt-out rate, the effective opt-out rate is actually between 40 and 43%--much higher than any behavioral finance studies suggest for an auto-enrollment program, and resulting in participation rates that are below that of opt-in plans.

B. *Average (mean) income of $45,000 for full time employee, which is higher than the median of $23,000 for the eligible population in the Market Analysis.*

Our income assumptions are based on a highly reliable data source and were effectively adjusted downward to be conservative.

- The income data is derived from the Current Population Survey from the U.S. Census Bureau and the U.S. Bureau of Labor Statistics, which labor economists recognize as one of the most reliable sources of earnings data.
- Our assumption of $45,000 mean annual wage income for full-time/year-round employees reflects a downward-weighted statistic based on a three-year average from 2012-2014 when the economy was still recovering from recession. In reality, **2014 wage and salary income averaged $52,000 for eligible full-time/year-round employees and $46,200 for all full-time employees.**
- Third, while there is a noticeable gap between median (50th percentile) wages reported in the Market Analysis and the average (arithmetic mean) values used in financial feasibility study, the two are derived from exactly the same set of income data. For the purposes of calculating aggregate contributions into the Program, the average (mean) wages are the appropriate input, not the median. Furthermore, our model accounted for differences in income by age.

C. *Number of workers enrolled. The feasibility model projects 1.6 million the first year, and more than 4 million workers when rollout is complete.*

The Board and some private industry observers have expressed concerns that lower-than projected-participation rates, either among employers or employees, will undermine the Program.

Given the cost structure of the Program and California's large size, it can be self-sustaining even if a large number of eligible employers choose to sponsor their own plan, or if 50% of employees choose to opt out.

- Much of the Program cost will consist of per-unit costs tied to employer count, employee count, and assets under management. For instance, in Year 5 in the baseline scenario, these costs will account for 69% of total Program costs.
- A large state like California has a generous cushion in terms of employee- and employer-level opt out rates. That is, it would will take a very large share of firms and employees peeling off to reduce the contribution base below the absolute minimum for sustainability.

i) What happens if a significant share of large employers (with more than 100 employees) decides to offer their own plan rather than participate in California Secure Choice?

This concern was highlighted as a "fatal flaw" by PAi.[6] This reflects a common concern that a significant share of employers—especially larger employers--will sponsor their own plans in response to the mandate, and that this will render the Program unsustainable.

Employer-sponsored plans such as 401(k)s and SIMPLE IRAs have the advantage of higher contribution limits and potential employer contributions, though existing offerings for small and medium size businesses have high average fees.[7] Such plans also impose costs and burdens that employers would not face under Secure Choice, particularly related to ERISA. Nonetheless, it is certainly is possible, as well as desirable, that financial services firms will offer high quality, low-cost retirement plans to entice some businesses away from California Secure Choice.

Ultimately, from the point of view of Program finances, fewer employers means reduced employer servicing and account servicing costs. As long as there is a large enough total base of contributing employees across which to spread fixed program expenses (i.e., core administration costs), the Program can be self-sustaining.

- For instance, even assuming that the maximum number of employer remain to be serviced, the minimum threshold for financial feasibility—defined in terms of startup loan payoff by Year 10—is about 1.25 million total active participants in

[6] Michael Kiley/PAi, "Response to the 'Final Report to the California Secure Choice Retirement Savings Investment Board,'" March 3, 2016.

[7] For instance, an industry study found that plans with $1M-$10M in assets had a median expense ratio of 127 bps, compared to 37bps for the largest plans. Deloitte & Investment Company Institute (ICI), "Inside the Structure of Defined Contribution/401(k) Plan Fees, 2013," ICI, December 2014. URL: https://www.ici.org/pdf/rpt_14_dc_401k_fee_study.pdf.

our Feasibility Model. This represents a 20% participation rate among the roughly 7 million employees eligible today.

- To the extent that the number of employers is reduced in this scenario, the active participant threshold is even lower.

It is worth noting that the study conducted for a similar retirement savings initiative in Connecticut—a state with an auto-IRA market that is one-eighth the size of California's—arrived at comparable findings about program viability and the timeframe for paying off startup financing. That study identified $2 billion in total assets as the threshold for self-sufficiency. In California, annual contributions alone will exceed $2 billion even if only 1 million of the currently eligible 7 million workers participate.

Even with the extreme scenario of participation among employers with 100-999 employees dropping to 50%, and no employer with more than 1000 employees participating, the Program will still be financially self-sustaining.[8] Startup financing need will increase from the baseline $89 million (per the corrected Financial Feasibility Study dated March 17) to $116 million—well within the 50% buffer recommended in our revised Final Report—and the payoff period will increase from 6 years to 7, after which participant fees can be reduced to about 60 bps. This assumes full state financing. As noted in our Financial Feasibility study, the startup loan amount and the payoff window can be reduced by increasing account fees by a small amount for the first several years, and/or by sharing some startup costs with vendors in exchange for longer-term contracts.

ii) What happens if employee opt-out rates are higher than expected?

See response to 2A above. We already incorporate a very pessimistic effective opt-out rate into our baseline model. Furthermore, effective opt-out rates would have to approach 66% to have a comparable impact on Program finances as having most larger employers peel off from the Program, described above.

3. Factual Corrections Related to Public Comments on Plan Demographics and Online Survey

The public comment letter from the Securities Industry and Financial Markets Association (SIFMA) makes several mistaken assertions about the demographic data in our study, with the goal of indicating that the eligible workforce is much smaller than the number used in our Financial Feasibility model.[9] In addition, SIFMA cherry-picks from the Online Survey results to

[8] In this scenario, half of employers with 50-99 employees are on-boarded in Year 1, to take advantage of slack capacity.

[9] SIFMA, Letter to The Honorable John Chiang, California State Treasurer, March 2, 2016.

conclude that only a small percentage of eligible workers will actually benefit from the Program. We correct those assertions and provide clarification below.

A. *Data on Plan Demographics*

- *Size of eligible workforce.* SIFMA cites "6.3 million potentially eligible workers." As the Market Analysis states in the first bullet point under "Key Findings" on page 27, our estimate is 6.8 million. This is based on the 3-year average employment in 2012-2014, per the Methodology section on page 26. As explained above, we used an older count of 6.3 million for the Financial Feasibility model in order to be conservative, and the current eligible population count is closer to 7.2 million, leaving a comfortable buffer.
- *Part-time workers and students.* SIFMA states that "the workforce skews young…. and likely includes a large percentage of part-time employees attending school." In fact, as we show in Figure C-6 on p. 31 of the Final Report, full-time workers make up the vast majority of eligible workers (83%), and part-time workers make up a minority (17%). (However, we assume 25% part-time employment in our Financial Feasibility model in order to be conservative.) In response to SIFMA's concerns, we analyzed CPS data on school attendance among eligible part-time workers. Full-time students make up only 6% of the total eligible workforce.

  At the same time, there is nothing intrinsic about student status that should preclude workers from participating in Secure Choice, except for concerns about reducing the potential number of low-balance accounts that may remain inactive for a few years. If the eligibility age were raised to 20, the share of full-time students would decrease to 4%.
- *Firms with less than 5 employees.* SIFMA asserts that the Final Report "does not appear to exclude the nearly 750k Californians who work for employers with fewer than 5 employees." As we state in the description of our market profile methodology on page 26 of the Final Report, only workers employed in firms with 5 or more employees were included. This data—albeit an older series with lower employment and wage counts, presented in earlier Board meetings—was the basis for the Financial Feasibility analysis.
- *Share of eligible participants precluded from participation by IRS rules*. SIFMA notes that "8% of participants could face income restrictions preventing them from participating in a plan." This 8% refers to two groups of workers: 1) married workers whose spouses participate in an employer-sponsored retirement plan and thus may not be able to contribute the maximum to a traditional IRA (but in most cases, can contribute to a Roth) and 2) and workers whose incomes prohibit them from contributing to a Roth (and in most cases, can elect a traditional IRA instead).

  Our recommendation is that Roth IRAs be offered as the default, with employee choice to opt into a Traditional IRA. If the Board chooses, a Traditional IRA can be offered as the default, with a Roth IRA option. In either case, a much smaller percentage than 8% is likely to be precluded from contributing to a Roth IRA *and* from contributing pre-tax to a traditional IRA—in which case they would need to decide whether to make post-tax contributions to a traditional IRA, or opt out of the Program altogether.

B. Share of Eligible Workers Likely to Benefit from California Secure Choice

SIFMA's assertion that only 15% of eligible workers will benefit is simply erroneous. It seems to be based on a highly selective reading of our Online Survey that ignores not only the general arc of the survey responses, but a large body of existing research on household retirement savings and auto-enrollment.

Indeed, the Online Survey as a whole indicates that there is strong demand for the Program and that a large share of eligible workers will participate. These findings are supported by official data demonstrating that workers are not saving enough, and empirical studies demonstrating that auto-enrollment makes a significant difference in improving retirement savings outcomes.

SIFMA begins its calculations with the statement, "Overture quantifies that 71% of uncovered workers are in fact already saving for retirement." (More precisely, 71% of survey respondents reported that they're saving for retirement; the limits of this data point are explained below.) SIFMA then assumes that the balance—29% of eligible workers—are the only ones that remain to be helped by the Program. Finally, they subtract 14% who reported in one question that they could not save for retirement at all, to arrive at 15%. Both the reading and the math are flawed.

To begin, workers who report that they are saving for retirement are not necessarily referring to dedicated retirement accounts. The Online Survey simply asked participants to estimate their savings rate, not how much was being saved and where. Based on our experience observing focus group discussions, it seems that a significant share of workers believe that they are saving for retirement, but are not actually depositing funds into a dedicated retirement account, much less a tax-advantaged vehicle like a 401(k) or an IRA. Often the funds are deposited in money market accounts, CDs, and other highly liquid vehicles that are routlinely drained to fund gifts, aid to family members, and unexpected household expenses. Whole life insurance policies were also cited as a form of retirement savings.

More importantly, nearly half of American households have no retirement savings, and the median total retirement account balance for working-age American families is less than $3,000, according to the Federal Reserve's Survey of Consumer Finances.[10] The median balance for families with heads age 33-37—close to the median age among workers

[10] Nari Rhee and Ilana Boivie, "The Continuing Retirement Savings Crisis," National Institute on Retiremen Security, March 2015. URL: http://www.nirsonline.org/storage/nirs/documents/RSC%202015/final_rsc_2015.pdf.

eligible for the Program—is just $480.[11] Based on this data, and the methodological issues outlined above, it is safe to assume that Online Survey participants over-estimated their savings rate.

In addition, while most retirement wealth is accumulated through workplace retirement savings programs,[12] California has the second lowest rate of workplace retirement plan access among private sector workers among states in the US.[13]

Finally, the Online Survey—taken as a whole—indicates that most workers *want* to save; that most would participate in California Secure Choice; and that the Program would result in increased saving:

- **73% reported that they would stay in the Program**, in response to a carefully designed behavioral experiment to gauge likely opt-out rates. (Based on empirical studies, likely participation rates will be significantly higher if the Program implements true default auto-enrollment that does not require employee action to begin payroll deduction.)
- **86% were confident that, if offered a workplace retirement plan, they "would be able to set aside some money to contribute."**
- 85% thought that auto-enrollment into a retirement savings plan was a good idea.
- 96% reported that it was important to save for retirement.
- When asked to choose from a range of specific dollar amounts that they could set aside in a workplace retirement plan, only 4% said "I don't think I could save anything."

While it is conceivable that participants are being overly optimistic about their capacity to save, a solid body of empirical evidence confirms that auto-enrollment plans make a huge difference in worker savings behavior. In particular, empirical studies have found that auto-enrollment makes the greatest difference for low-income workers, increasing their participation in offered retirement plans from about 1 in 4 to at least 4 in 5.[14] These are the workers who are most likely to claim economic hardship as a reason for not saving on their own, yet they do end up saving when they have the opportunity to contribute to a retirement account through automatic payroll deduction.

[11] Monique Morrissey, "The State of American Retirement: How 401(k)s Have Failed Most American Workers," Economic Policy Institute, March 3, 2016. URL: http://www.epi.org/files/2016/state-of-american-retirement-final.pdf.

[12] While most retirement account assets are held in IRAs, they are mostly the result of rollovers from 401(k)s and other employer-sponsored retirement accounts. See for example Investment Company Institute (ICI), "The IRA Investor Profile: Traditional IRA Investors' Rollover Activity, 2007 and 2008," ICI, December 2010. URL: https://www.ici.org/pdf/rpt_10_ira_rollovers.pdf.

[13] Authors' analysis of the 2015 Current Population Survey/Annual Social and Economic Survey from the U.S. Bureau of Labor Statistics.

[14] Clark, Utkus & Young, op cit.; Brigitte Madrian and Dennis F. Shea, "The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior," *Quarterly Journal of Economics*, v116n4, pp. 1149-1187.

Response to the “Final Report to the California Secure Choice Retirement Savings Investment Board.”

As prepared by Overture Financial, LLC Dated January 31, 2016

This response to that report is prepared by:

Michael P. Kiley

mpkiley@pai.com

March 3, 2016

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Comments in this report are offered from the perspective of 33 years of experience designing retirement solutions for small business and the brands that serve small business. For purposes of this report, please note that the author is not licensed to practice law, accounting or any investment role of any nature. Where plan operational comments address investments, those comments are offered from the perspective of a recordkeeper and the operation of those investments in a savings program. None of the comments within are intended to address the topic of investment suitability, performance or risk at the individual, program or system level.

A Word to the Reader

I'm going to apologize in advance for what you are about to experience. The topic of designing and implementing retirement systems for a population of customers, community members and stakeholders can seem complex. Writing to the topic from one perspective – provider, participant, regulator, etc… is difficult enough. In this work, I'm trying to address the more important aspects of the proposed program from the perspective most affected by or invested in various design decisions. The result is a work that is rich in information supported by examples and nearly completely lacking in elegance. I have provided recommendations at the end that I believe are in the best interests of all. Thank you for your patience. Thank you for the opportunity to contribute to an important effort.

Executive Summary

The California Secure Choice (CSC) initiative is a breakthrough effort on a difficult challenge.

It represents an opportunity to move the public private retirement readiness partnership forward in a transformational way. Given the current status of Federal retirement policy and the effort put forth by the contributors to the California Secure Choice initiative – it is appropriate to think of this effort as national in scope. Its effect is certainly being felt that way.

California Secure Choice will achieve the goal of increasing savings participation for over 50 million American workers – only a portion of whom are in California. The payroll and retirement industry response to CSC has never been localized to California. It has always included the element of national scope. Even the term "Secure Choice" is becoming a recognizable industry and policy term – meaning a state workplace retirement savings initiative.

There is a lot of opportunity to get a number of things right in the execution of California Secure Choice. There are very few opportunities to get any design decision monumentally wrong. Those opportunities are very easy to recognize and largely have been recognized by the Board to date. There are opportunities to move the topic forward dramatically – and the market along with it – to the benefit of workplace savers across the nation. It is hoped that those opportunities are seized here.

The Overture Financial report is very well done. This is a big subject with a lot of layers. I admire what they've accomplished given the scope of the topic. My comments here are designed to address specific significant areas of the report with which I disagree as well as to provide suggestions for a path forward.

The Right Way to Think About This Challenge

Most of the conversations that I've witnessed or participated in regarding California Secure Choice or programs like it are plagued by the same mistake the retirement industry has made for decades.

We keep the conversation focused inward and too small. What is the right investment? Plan design? What products and services do **we** have to match up to the need?

The fact is that retirement readiness is an issue that retirement solutions like CSC address for the entire economy, not just the buyers and suppliers in the retirement industry.

In simpler terms, CSC is designed to address the gaps in retirement readiness for 7 million individuals with an average annual household income of $25,000 per year – a nearly $175 billion dollar economic impact. In overly simplistic terms, if CSC fails to deliver success, it could be predicted that those 7 million individuals will drop down to social security incomes of less than half of that $25,000 value. That's a nearly $90 billion reduction in consumer behavior. (Please pardon the oversimplified math.)

Even for the world's 7th largest economy – that's a big impact. Working together, we can keep that $90 billion growing California.

If we keep the conversation small and focused inward, we will miss a world of opportunity to work with the parts of the economy that are interested in that $175 billion opportunity.

The same business community that doesn't want to lose a $175 billion market or face the burden of supporting 7 million unfunded retirees – is looking for a solution that facilitates success in an outsourced solution at a reasonable cost. The market has that to offer.

The California Secure Choice Program Will Be a Success if Success is Defined

The CSC has already been impactful. Judged by the number of states that are initiating similar actions, the CSC is at the center of a very necessary movement to improve retirement outcomes.

The mandate contained within the legislation opens markets.

The definition of success needs to be determined before a successful program and launch can be defined and implemented. Unfortunately there is the potential for significant misalignment between the way the program is designed and the success it is projected to enjoy.

A determination needs to be made whether the goal of the CSC is;

A) Provide a low cost safety net solution for employers and their employees who desire a low cost low risk workplace savings solution OR
B) Build a best in class solution that gathers significant participation and assets.

Either path will produce a successful outcome but it is imperative that this decision precedes any design or implementation decisions.

The Fatal Flaw in the Report

A word of caution on a fundamental assumption on workplace retirement savings.

There have been many policy discussions that predate the CSC initiative that are predicated on the belief that the existing workplace savings industry or 401k industry lacks the ability, capacity, desire or product to meet the needs of the employers and savers targeted by Secure

Choice. It is a mistaken presumption that poses a significant threat to the CSC initiative. The workplace savings industry has had affordable options available for years.

What has been lacking is market demand that makes it possible to profitably drive those products and services into the marketplace. Small business has any number of present day challenges – taking on "future" challenges is typically not in the time or financial budget. The retirement marketplace has evolved the ability to outsource the significant functions that go along with hosting a workplace savings solution for employees. The market has not yet figured out how to get that model adopted profitably. The mandate in California Secure Choice closes that gap simply and is an important step toward success for all stakeholders.

One of my greatest concerns with the final report as presented is the assumptions it makes - and the expectations it creates - around how many savers/subscribers will join the program.

It is my belief that the California Secure Choice program will enjoy enough subscribers (account holders/savers) to be viable – but I think the assumptions of utilization need to be adjusted downward – significantly. As an example, the over 100 life rollout assumption assumes that greater than 50% of the current non plan sponsor market share will go to California Secure Choice. Based on three decades of working with plans and employers in that marketplace, I believe that assumption is 2 to 5 times too high. Existing market relationships will efficiently address 80% of that marketplace when the implementation phase begins. The over 100 life market is a highly desirable market for private sector firms that serve the small business marketplace. The market is already forming campaigns to serve employers affected by the anticipated mandates with attractive solutions.

The report does not provide enough information or examples of existing programs that will compete with CSC. Nor does it do an adequate job of differentiating the product utilization projections for the two significant fund paths illustrated – "Balanced Fund" vs. "Pooled Fund with Reserve". A balanced fund option is a much more attractive option in the marketplace and will enjoy a significantly different level and nature of uptake in the marketplace. Within the report it is called out that while "investment choice" was third on the list of important features and attributes – more than 70% of people surveyed would choose a balanced fund over a pooled fund. The market will have fabulous options for that 70% if CSC goes the Pooled/Reserve route.

If the California Secure Choice Board is challenged to carry the burden of connecting with 7 million potential workplace savers but is only able to capture 10% of that population – the impact on the program could be devastating. I believe the projected utilization of the program is far higher than what will actually be experienced and it puts the proposed program at risk. Program launch strategies and attendant costs need to be aligned and managed carefully.

The Danger of the Pooled Account with Reserve

As a recordkeeper and savings program designer I am very concerned about and disagree with the notion of using a Pooled Fund with a Reserve for Gains and Losses. That type of structure in an IRA based program poses some significant challenges and risks. The following are some operational considerations that the Board will face – none of these considerations is an easy pill to swallow.

The most significant issue the Board would need to decide is a policy on how distributions would be processed. The choices would be as follows – each with its positives and negatives.

Path One – Limit Distributions to once per year. Only pay out benefits once a year when reserve determination is made. In limiting access to funds, one might think this will have an anti-leakage effect but in fact it will have an anti-participation effect. People will avoid saving here if they are not able to make withdrawals when desired. If the decision is made to NOT limit distributions, then one of the following options must be chosen.

Path Two – Catch Up Distributions. After the end of the year actual results are posted and the board would decide on adjustments with the reserve - in years where the board decides to enhance returns – the recordkeeper would be required to go back and adjust all plan distributions from the prior year with a second distribution. This doubles the distribution costs, straddles tax reporting over two years, potentially calls for a bifurcated payment if the participant status changes ,etc… it's a difficult recordkeeping strategy.

Path Three – Fixed Policy for mid-year distributions. Adopt a policy that provides a formula for determining investment outcomes for mid-year distributions. As the recordkeeper is processing distributions throughout the year, if a participant requesting a distribution is facing a realized loss for this year, the recordkeeper would true it up to zero and bill the reserve account. That might have the recordkeeper drawing on the reserve account even in years where the fund is up for the calendar or investment year. Viewed at its worst, participants who stay could be funding participants who go. This would be true anytime there was a down point during a year and participants exited without experiencing their losses.

Path Four – Mid Year distributions are excluded from reserve participation. This approach has a hidden problem. Imagine if you would that it's the tenth month of the "reserve year" and participants can clearly see that the fund has had a very good year. Somewhere in the marketplace will arise a "CSC Alert" social brand. That "Alert" might issue a "Sell" if the fund is up – attempting to inspire account holders to withdraw their funds before the reserve determination is made and actual gains are potentially reduced. The call center will get flooded with redemption requests.

Path Five – A hybrid or combination of approaches.

Any of the paths chosen will cause a multiplication of the costs for benefits processing, an increased cost exposure to the guarantor or guaranty process, an increased cost for participant education or support, and or the potential for a lot of bad press.

I attended public hearings and it became quite clear in testimony and private casual conversation that there is a tremendous risk that the Pooled Fund with Reserve will be misunderstood. The range of misunderstandings I experienced included the following;

> The fund can't lose money,
>
> That it has a guaranteed return rather than downside protection,
>
> Very little understanding that in good years gains could be peeled off for later years,

And at the very worst just one person who was under the impression the account would self-fund – that they would agree to the account and it would be funded for them.

Those are just the four perceptions that I heard. The anti-disinformation campaign required on a choice like that is going to be expensive and difficult. If it isn't properly engaged, the call center will bear the burden – and likely fail. No one withdraws their savings faster than a person who just realized they may not have understood what they were putting their money into.

Pooled Funds with Gain/Loss Reserves have a long history of success in plans with the artificial behavioral constraints of plan rules, product and trust policies. It is typically understood in those voluntary and often employer funded plans – that account balances are not immediately liquid.   In the very different environment of individual IRA's that arrangement will pose significant risk to the overall program. At the very least – unattractive policies meant to make the pooled/reserve arrangement functional – will make the program unattractive and drive down utilization.

If the "pooled fund with reserve" option is chosen, the projected utilization is dramatically overstated and resulting program costs are dramatically understated in my opinion. This type of program will not capture 50% of the initial launch wave while the market is providing much more attractive options.

Employer Responsibilities and Risks are Limited in Private Sector Solutions.

In today's Fiduciary care models – the role of the employer is limited to the following;

Provide accurate and timely employee data.

Provide accurate and timely contribution data.

Remit contributions in an accurate and timely fashion and form. (Usually electronic).

If the employer is using a payroll service or software for the most part they will be able to opt into payroll integration that does not require them to provide any of that data in a manual fashion. It should be noted that companies with over 100 employees very rarely do payroll without a system or service. Those companies will already have robust solutions available to them from familiar brands that they will likely engage in the presence of a mandate.

The employer is decoupled from the employee with today's available retirement services. Employees/participants are connected directly to the platform savings provider/recordkeeper and or a rep in the field. That connection happens via text, app, email, call center or chat. There is also a rapidly expanding list of Employee Self Service portals where employees can go for their health, tax and benefit forms and information – all directed to the micro and small market.

Micro and small employers can outsource the responsibility for ensuring their participants' retirement goals are properly set and that participant actions are documented and directed to meet those goals.

Bottom line is that the CSC will not enjoy an advantage in reduced employer or employee risk management nor enhanced customer experience.

Facilitate Success for Now – Educate For Success Later

I want to caution the readers of the paper to not make the mistake of treating this population of target savers too differently than the rest of the saver's worldwide both inside and outside of save at work plans.

The workplace savings industry was initially served directly by the manufacturers of investment products – so retirement work looked like investment work or products. The bulk of workers don't want to be burdened with the need to know the ins and outs of investing and investment choices so the immense quantity of information in those solutions was a deterrent for them.

This isn't unique to savings opportunities. The bulk of car buyers don't want to know whether the car they are purchasing has electronic or mechanical fuel injection or whether the tires are filled with nitrogen (good idea) or oxygen. They just want to know that they turn the key and drive it. Soon, they will want the *car* to know that its time to warm up and drive them to work. Employers and workplace savers want the same thing from their retirement plan – and the retirement industry has produced solutions.

Education will need to be focused not on the spectrum of investing but on how to think about long term vs. short term savings and help the user self-identify the appropriate course for them.

I can say with near certainty that every leading market solution available today is designed to engage the active saving enthusiast while also providing a sensible default path for savers who do not engage with the tools, calculators and other solutions available to them. The need to work successfully with unengaged savers and non-savers is already baked into market offerings from the private sector.

The "F" Word

There is a lot of energy being spent these days on the issue of Fiduciary liability and Fiduciary services. The market is successfully closing that gap.

Traditionally "Fiduciary" was described as a fog that covered the industry, the providers, distributors, plan sponsors and savers in a mist. A mist from which at any moment some unknown force could reach out and introduce mayhem. The industry has followed some familiar approaches –

> Be involved in everything and charge for it.
>
> Be sure that everyone understands your brand is "not it".
>
> Big Data – used well or not well.

In fact, the market has come to realize that "Fiduciary" is a data driven issue – small data – not big data. Each and every day a participant's journey to retirement readiness does one of three things – gets better, gets worse or remains neutral.

> Some things are obvious. If a participant reduces their contribution, invests in too much or too little risk – retirement readiness is negatively impacted.
>
> Some things are not so obvious. A pay raise resets the bar for retirement readiness. A retirement raise should accompany the pay raise.

Systemic Fiduciary issues such as choosing investments at arm's length and cost management are pretty well wired into the market today. Stated simply – it's pretty easy to stay out of trouble on those issues if you choose to do so.

The market has a number of Fiduciary service models available today – from investment centric designed to keep the investment choices in line with plan rules/policies all the way to participant outcome centric designed to guide, promote document and reward behaviors.

To the extent that the Program is to be differentiated by its Fiduciary protection – it will not be. The market already has many flavors and many prices to cover that.

Best Practices – Investment Policies and Options.

In order for the Program to capture market share it needs to be in step with what the market has to offer. The state of the art these days is for a plan to have a selection of managed portfolios aligned with varying levels of target risk. Employees are defaulted - according to policies set by the investment fiduciary – into the portfolio that most suits their position on the journey to and through retirement. The participant is notified and allowed to adjust to a different portfolio as they choose. In today's marketplace there are organizations that sell the service of matching the saver to the portfolio. In the past, investment choices were made available and participants were required – without regard to their knowledge or comfort level – to make a choice or choices from among the funds offered. Today, the participant can be appropriately placed in the portfolio by a fiduciary service. This approach facilitates success for the unengaged while allowing choice for the actively engaged – all the while protecting the employer from liability for participant choices.

The market has evolved to a higher standard of care. Care should be taken to make decisions in 2016 that are not based on 2011 market offerings.

The employer who has a population of employees with the exact same level of investment expertise and interest doesn't exist. Forcing all employees into a plan with no choice and no guidance invariably underserves some portion of those employees. Much better that we use readily available solutions in the marketplace to *install the financial expertise as a feature of the program*.

Investing a 25 year old like a 65 year old does that 25 year old the disservice of opportunity cost. Investing a 65 year old like a 25 year old introduces tremendous risk of significant, negative, unrecoverable outcomes for the 65 year old. Investing the 25 year olds and the 65 year olds like a 45 year old is a fine compromise – but with today's technology and available services it isn't required – so why do it? It will make the program noncompetitive, add risk, complicate communication and drive down utilization.

The main danger for savers is committing money needed for short term issues or contingencies to the risk of the marketplace. There are a number of ways to address that risk in the program design while still allowing individual active choice. An example would be to direct initial contributions into a stable value fund until the balance hits a prescribed value and then open up market opportunities.

In addition to the concerns above there is a scenario that will be common and on its best day will result in employers choosing a market solution. Many business owners who are subject to the mandate will also not qualify for a Roth IRA due to income exclusions. As a result, they may set up the state plan for their employees and get a separate IRA for themselves. Anytime an employer creates separate benefit solutions for themselves vs. their employees it introduces the risk of someone taking issue with the fees, outcomes or features of the two solutions.

Innovations and Opportunities

The following are some innovations and opportunities to consider for program rollout and legislative efforts.

Short term vs. Long Term investments. New savers have a higher level of concern for investment losses in early years. I am in favor of a design that places participant money in a money market or stable value type of fund during the first 90 days of contributions – until they no longer have the option to "reverse their contributions". Beyond that the market has seen its best results matching the participant to the portfolio using a service that does so.

Interoperability – The Board needs to be given the latitude to let the recordkeeper "push" customer information where they authorize it and where they will make the best decisions for themselves. Customers should be allowed to have their account information available in their bank site, tax site, personal bookkeeping package, employee HR site, etc…

Rewards and Gamification – The Board needs to be given the latitude to introduce behavioral rewards into the program. California has a tremendous opportunity to move "saving" forward with an overt strategy on this topic.

Social Security – item one for most workers' retirement is Social Security. It would be very helpful if California took an active voice in requesting the Social Security Administration to allow participants to authorize the SSA to transmit their data to their specifically authorized savings tools. Many conversations would be shortened by having the actual data available in the support conversations. It reduces expenses.

Automatic Re-Enrollment – I do not believe the report dealt overtly with the topic of re-enrollment. I strongly suggest that the Program be allowed to re-enroll participants who opt out at some interval – say every three years. Two would be better.

Automatic Escalation – the industry has moved beyond the "1% on January 1" model. The Board should be empowered to allow other forms of escalation – birthday notices ("Happy Birthday – give your future self a year off - $24.70 per paycheck – click here"), work anniversaries, pay raises, reward systems, etc…

Intermediaries at the employer and employee level – The communication and operational costs of the program will be significantly reduced if the recordkeeper is allowed to formalize the role of intermediary at the employer and employee level. The intermediary is someone who could be allowed to view accounts, receive automated updates – and with proper controls – provide data or a very limited instruction set.

Participant communication. The Board should be allowed to engage best practices with participant education. Participants should be provided with opportunities to "acquire retirement" rather than "defer pay". When a participant takes a distribution from their account, the recordkeeper should be allowed to present that withdrawal in terms of how much retirement it represents. "Dear Participant, A withdrawal of $X,XXX now will reduce your projected retirement funding by X years. Let us help you find alternatives to protect your retirement."

Recommendation

The mandate is something that I disagree with personally, however professionally there is no denying that it will close a gap that needs to be closed. As a business owner I am troubled by that fact, however as a business owner I prefer to head off problems when I can. The mandate proposed by California is a necessary first step to head off a large portion of a problem that faces the entire economy – not just the retirement industry. Where the industry was ten years ago or even five years ago – I would have spoken against the mandate in loud and clear terms. Given that the industry has evolved to an outsourcing solution for the small and micro market that adds value to its customers at prices that meet the expectations of most state initiatives – the mandate will be effective without being harmful.

The fastest, lowest cost, lowest risk path to getting the goals of this legislation covered is a mandate with a marketplace. Best practices in evaluating providers can be built in and the market bears the much reduced cost of outreach and implementation where a mandate exists.

To the extent that a state solution is deemed necessary or desirable;

Keep the legislation as loose and market responsive as possible. There are clear gaps between what the market was five years ago and what it is today. The Board should be empowered and charged with the decisions necessary to keep the program up to date and successful. Contributions, investments, education and decumulation strategies should, as much as possible be left in the hands of the Board. The pace of innovation must be supported.

Investment Choice – The business goal is met with a single fund solution of a stable value or conservative nature. It will serve its goals and cost of implementation will be low. A best in class solution is an option that will require considerably more money and time to reach the coverage goals of the legislation.

If the CSC is geared to a one fund choice solution whether it is market based or stable value– the offering is not going to compete well with market offerings that include options, individual selection – and most importantly – built in fiduciary support at the employer and participant outcome level.

If the CSC is designed to align with a known definition of success – it will meet the goals and needs of the community it serves – and set an example for the remainder of the country that is paying such close attention to this breakthrough effort.

PolicyLink

March 11, 2016

John Chiang, State Treasurer and Chair
Christina Elliot, Acting Director
California Secure Choice Retirement Savings Board
915 Capitol Mall, Room 110
Sacramento, CA 95814
Fax: (916) 653-3125

RE: Comments on *Final Report to the California Secure Choice Retirement Savings Investment Board*

Dear Treasurer Chiang and Director Elliott:

PolicyLink would like to thank the California Secure Choice Retirement Savings Investment Board ("Board") for the opportunity to comment on Overture Financial's *Final Report to the California Secure Choice Retirement Savings Investment Board* ("Report") and for its ongoing leadership in developing the California Secure Choice Retirement Savings Program ("Secure Choice"). We would also like to commend Overture Financial on the *Report* and the extensive research and analysis that led to its creation.

Overall, the *Report*'s recommendations, if accepted, would provide a simple, easy-to-use retirement savings program that balances the goal of maximizing retirement income while limiting risk for employees. Nonetheless, several of the *Report*'s recommendations raise concerns and should be carefully scrutinized and, in some cases, rejected by the Board. This letter briefly examines the *Report*'s recommendations in the following areas: automatic escalation of contribution rates, pre-retirement withdrawals, worker education, and the statutory provision mandating the collection of employee signatures prior to enrollment. It also discusses the potential impact of Secure Choice accounts on participating employees' eligibility for public benefits.

<u>Automatic Escalation of Contribution Rates</u>

The *Report* recommends that the California Secure Choice Retirement Savings Trust Act ("Act") be amended to allow the Board to automatically increase Secure Choice IRA contribution rates to 10%, in increments of 1% per year.[1] We are concerned that this recommendation could cause participants to *unknowingly* contribute more money to their accounts than they can afford.

According to the *Report*, the median income of Secure Choice-eligible employees is only $23,000.[2] With such a small amount of income, many program participants, after factoring in basic needs like housing, food, and transportation, are likely to have difficulty contributing at even the *Report*'s recommended 5% default rate. At the same time, because the recommendation proposes that rates increase automatically, program participants, many of whom may not be accustomed to monitoring a savings or retirement account, may be unaware that their contribution rates are climbing to unaffordable levels. This could be problematic for workers who are living paycheck to paycheck and for whom every dollar earned is essential.

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[1] Overture Financial, *Final Report to the California Secure Choice Retirement Savings Board* (February 9, 2016), 7, 17.

[2] Ibid., 19.

In light of these concerns, we urge the Board to reject the recommendation. We also strongly encourage the Board to establish a notification process that informs program participants prior to any change in their contribution rates. The notice should provide sufficient time for employees to fully consider the potential impact of a rate increase on their finances and remind them of their right to determine their contribution rates.

Hardship Certification Requirement for Pre-Retirement Withdrawals

The *Report* recommends that employees be required to "self-certify hardship" before withdrawing funds from their accounts.[3] We urge the Board to reject this recommendation, for three reasons. First, it would treat Secure Choice IRAs differently than normal IRAs, without adequate justification. On its face, the recommendation would prevent program participants from withdrawing funds from their accounts, unless they certify that they are facing hardship. Neither a Roth IRA nor a Traditional IRA imposes such a requirement. The *Report* does not explain why the rules governing withdrawals from Secure Choice IRAs should differ from those that apply to other IRAs, although it notes that limiting withdrawals will maximize retirement income. Nor does it define hardship or provide details about the certification process. While we agree that limiting withdrawals could boost retirement savings for program participants, the *Report* does not demonstrate why that fact alone justifies treating Secure Choice accounts differently than other IRAs. The Board should not accept a recommendation that represents such a significant departure from normal IRA rules without a more robust justification and explanation of what the certification process would entail.

Secondly, the "hardship" requirement would undermine a key feature of Roth IRAs, the default account type recommended by the *Report*. A chief benefit of Roth IRAs is the relative ease with which funds can be withdrawn from them prior to retirement. Contributions to Roth IRAs, may be withdrawn, at any time and for any reason, without taxes or penalty, and account holders can deduct investment earnings tax and penalty free in certain circumstances. The flexibility to withdraw funds easily would be especially valuable for Secure Choice participants who, due to limited income, are likely to face financial emergencies that require them to access their retirement savings. By imposing an additional requirement on the withdrawal of funds from Secure Choice IRAs, the recommendation would make it more difficult for families to draw down their funds in an emergency.

Finally, mandating that workers certify hardship to withdraw funds could, as the *Report* states, lower program participation rates, because "a significant share of eligible workers would be disinclined to participate if they cannot access their funds in emergencies."[4] If the Board adopts the recommendation, it should ensure that the criteria for demonstrating hardship are so easily met that withdrawing funds from Secure Choice IRAs is not more difficult than deducting money from IRAs operating under typical rules. Moreover, the Board should give the public a meaningful opportunity to provide input on the definition of "hardship" under the law and the design of the certification process.

Worker Outreach Program

The *Report* recommends that the Board partner with worker organizations, unions, community organizations, and asset building groups to develop and implement a worker outreach program that focuses on educating employees.[5] We appreciate the *Report*'s emphasis on education and agree that the Board should partner with non-governmental entities to develop the outreach program.

Properly educating the nearly 7 million employees who are eligible for Secure Choice is a substantial undertaking that will require significant resources, yet the *Report* does not specify a source of funding for the effort. We recommend that the state set aside a substantial amount of funding to ensure that the worker

[3] Ibid., 15.
[4] Ibid., 23.
[5] Ibid., 7.

outreach program recommended by the *Report* is adequately resourced. Without financial support from the state, the Board will likely be forced to rely on external sources of funding, which could potentially delay the implementation of Secure Choice.

Requirement to Collect Signatures Prior to Program Enrollment
Under the Act, employers must provide employees with a Secure Choice information packet developed by the California Employment Development Department, and employees must sign a disclosure form acknowledging their receipt and review of the packet.[6] According to the *Report*, employers must collect the signed forms before their workers can be enrolled in the program.[7] The *Report* recommends that the Act be amended to eliminate the requirement that employers collect the disclosure forms before enrollment in Secure Choice.[8] We believe the existing statutory requirement is a useful protective measure that ensures workers receive and review information about Secure Choice before being enrolled in it. Therefore, we recommend that the Board reject the *Report's* recommendation.

Secure Choice IRAs and Eligibility for Public Assistance
The Board should recommend that the legislature, consistent with the state's authority, exclude Secure Choice IRAs from asset limits for public benefit programs. To qualify for some public assistance programs, such as Medi-Cal and CalWORKs,[9] an individual must have a limited amount of assets – savings, investments, and property[10]. If the total value of a recipient's or applicant's assets exceeds a program's asset limit, he or she will be ineligible for benefits. Currently, it is unclear whether funds held in Secure Choice IRAs will count toward existing asset limits for some of the state's public benefit programs. In order for Secure Choice to be effective for low-income workers that receive public assistance, the state should exempt retirement savings accrued through Secure Choice from any asset tests used in determining eligibility for public assistance.

If the state does not exclude Secure Choice IRAs from asset limit tests, Secure Choice participants could be disqualified from receiving other public benefits, undermining the very goals of Secure Choice of improving retirement security, as well as the goals of current public assistance programs. The potential impact of Secure Choice IRAs on eligibility for public benefits is not discussed in the *Report*, but must be addressed in any future legislation.

We hope this letter assists the Board in finalizing its recommendations for the design of Secure Choice. If you have any questions regarding the letter, please contact Lewis Brown, Jr., at 510-663-4322 or Lewis@policylink.org.

Sincerely,

Angela Glover Blackwell
President and CEO
PolicyLink

Cc: Sen. Kevin de Leon, Senate President Pro Tempore

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[6] Cal. Gov. Code § 100014(d) (2012).
[7] *Final Report*, 13, 17.
[8] Ibid.
[9] Department of Health Care Services, *Medi-Cal General Property Limitation* http://www.dhcs.ca.gov/formsandpubs/forms/Forms/MC%20Information%20Notices/MC007ENG(0414).pdf; LA County Department of Public Social Services, "CalWORKs Eligibility," http://www.ladpss.org/dpss/calworks/eligibility.cfm.
[10] Some property may be excluded when calculating the value of an individual's assets.

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March 7, 2016
Christina Elliott
SCIB Executive Director
Office of State Treasurer John Chiang
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And via email

Dear Christina,

Prudential very much appreciates the opportunity to provide written comments on the "Overture Financial Final Report to the California Secure Choice Retirement Savings Investment Board", prepared by Overture Financial LLC. Prudential is the second largest life insurer and a top 10 global asset manager with over $1.2 trillion in assets under management. We are the leader in delivering income and protection solutions in the defined contribution marketplace. We help meet the needs of over 4 million participants and annuitants, and we are the largest in-plan guaranteed lifetime income provider, with a 47% market share.

Prudential has long been committed to expanding retirement savings opportunities for all working Americans,[1] and has long been concerned about what is often referred to as the "retirement coverage gap," that is, the absence of workplace based retirement savings opportunities for employees in many of today's small businesses. It is well established that employer-sponsored retirement savings plans have become a critical component of the private retirement system in the U.S., and a proven tool for helping working Americans prepare for life after work. According to calculations by the nonprofit Employee Benefit Research Institute, workers earning between $30,000 and $50,000 per year are 16.4 times more likely to save for retirement if they have access to a workplace plan.

Unfortunately, tens of millions of working Americans don't have access to a plan on the job, leaving many ill-prepared to meet their financial needs after they stop working. With 10,000 individuals reaching retirement age each day, this is a large and growing problem. We know that a comprehensive retirement plan requires a three-legged stool – Social Security, personal savings, and pensions. While Social Security is a critical program, for median income earners, it replaces only 47% of pre-retirement income,

[1] See Prudential white paper entitled *Multiple Employer Plans: Expanding Retirement Savings Opportunities* (2015) at http://research.prudential.com/documents/rp/mep_paper_final_2015.pdf.

leaving those without a workplace retirement plan with a potentially significant income gap in retirement.

The workplace retirement system works very well for employees of medium and large companies. Employees of small companies, however, are far less likely to have access to savings opportunities. According to data from the Bureau of Labor Statistics, only 50% of workers in firms with fewer than 100 employees have access to retirement plans at work. This compares to 89% for workers at larger firms.

This retirement coverage gap is especially problematic given that small employers provide jobs for a large and diverse section of the American population. Small businesses in the private sector provide over 30 million jobs for women. Small businesses employ over 12 million Latino Americans, 6 million African Americans, and 4 million Asian Americans - and yet, only 50% of employees of small businesses have access to a workplace retirement plan.

The retirement coverage gap can and should be narrowed. We commend the SCIB for its significant accomplishments in developing the program to provide retirement plan access to California's 6.8 million private sector employees who don't have a retirement savings plan at work, and congratulate the Board on the important step of producing this report. We share a common goal- to expand workplace based retirement coverage, and to enable financial security for all of California's workers. Prudential also shares many of the core principles and statutory objectives that you have focused on including low cost and simplicity. We have appreciated the opportunities to discuss the Program with the Board to date. It is important that every feasible effort to expand retirement coverage be successful, and we respectfully submit the following comments on the report for the Board's consideration.

Default Contribution Rate of 5%, with Automatic Escalation to 10%

Prudential commends the Board for the recommendation of a default contribution rate of 5%, with Automatic escalation in 1% increments up to 10% (after program phase in, subject to recordkeeping coordination.) While there are no hard and fast rules as to what constitutes an optimal default deferral and escalation rate, Prudential Retirement's accumulated data suggests that a 5-6% default deferral rate, with 2% annual acceleration up to a cap of at least 10-12% significantly improves the likelihood of successful retirement outcomes while maintaining participation levels.[2] A default contribution rate of 5% will go a long way to delivering meaningfully higher Retirement Security.

Multiple Employer Plan

The report concludes that California policymakers should consider whether the Board should have the discretion to establish a Multiple Employer Plan (MEP) in the future to

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[2]. See Prudential white paper entitled *Overcoming Participant Inertia* at
http://research.prudential.com/documents/rp/Automated_Solutions_Paper-RSWP008.pdf

receive voluntary employer matches to employee contributions. A MEP is an arrangement that enables unrelated employers to join together to sponsor a single employee benefit plan. MEPs have been utilized successfully for years by trade associations and professional employee organizations. Prudential is working with Congress to broaden the availability of MEPs to unrelated employers ("Open MEPs").[3]

The Department of Labor, through its Interpretive Bulletin § 2509.2015-2[4], gave states the unique authority to create an Open MEP. This authority for California to create an Open MEP was not available until late in the feasibility study process (November 2015). We strongly encourage the board to consider offering a MEP as a complementary option to the IRA, and to use it for a broader range of circumstances than receiving voluntary employer matches to employee contributions.

MEPs offer a number of benefits when compared to an IRA program, for both employees, employers, and the state. From an employee's perspective, one of the most important differences between a MEP offering a 401(k) plan and the proposed program is the amount of total contributions to the retirement plan that are permitted. The total contribution limit (in 2016) for individuals under 50 years old is $18,000 in a MEP sponsored 401(k) plan, compared to $5,500 for an IRA. $5,500 may be an inadequate limit for many individuals given their income needs in retirement. Next, as recognized in the report, a MEP can receive voluntary employer matches to employee contributions. Employer contributions can be an important component of retirement savings.

A broader range of investment options may be available in a MEP than available through the program, based upon the recommendations in the final report. Principal protection options, which guarantee principal and accumulated interest, were not part of the final report's recommendations. Given the median wage & salary income for this group is $23,000, and the mean is $35,000, and the number of individuals with limited investment experience, principal protection options may be an important investment option to offer this population. Furthermore, given the goal of delivering retirement security, it is important to think about retirement security in terms of income in retirement, in terms of creating a retirement income paycheck. To achieve this goal, guaranteed lifetime income investment options such as a variable annuity with a Guaranteed Minimum Withdrawal Benefits (GMWB) can create lifetime retirement income, and may also be available in a MEP.

From an employer's perspective, as part of implementing the Program, California's small business community will need to undergo a series of startup related costs. These costs may include updating payroll systems, providing notices as required by the program, and maintain and providing records to the state. A MEP would provide the advantage of allowing small businesses in California the ability to offset some of these costs, through tax credits. Under current tax law, small businesses can claim a tax credit for starting a retirement plan. The credit equals 50% of the costs, up to a

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[3]http://www.finance.senate.gov/imo/media/doc/Kalamarides%20Testimony%20Jan%2026%202016%20-%20Senate%20Finance%20Comm.pdf

[4] 80 Fed. Reg. 71936 (November 18, 2015).

maximum of $500 per year for each of the first three years of the plan. This tax credit is not available for small businesses under an IRA Program.

From the state and employer's perspective, a MEP, as an ERISA plan, benefits from a long-standing regulatory structure with important consumer protections, and strong protections from creditors. The State Sponsored IRA regulatory framework is new, and there are some unknowns for employers. For example, the ERISA implications if a handful of employers do not comply with the compliance requirements of the program are at this time unclear. Given these differences, some employers and employees would be more comfortable with the clarity and protections inherent in the ERISA framework.

Guaranteed Lifetime Income as part of the Default Investment Option

With an estimated 10,000 Americans reaching retirement age every day, we know that very few of those individuals are being offered the opportunity to consider a guaranteed lifetime income option as part of their retirement plan. We also know that few of today's workers are able to manage investment and longevity risks in retirement on their own. As recognized by the Council of Economic Advisers' February 2, 2012 Report, *Supporting Retirement for American Families*, this is a particularly significant issue for women, who tend to have lower retirement savings rates than men, while also having longer life expectancies. Guaranteed lifetime income solutions provide a means by which all workers can enjoy both certainty and security during their retirement years.

The report concludes that initially (in the first 3-5 years), account balances for retirees under the California Secure Choice Plan will be too small to convert to a meaningful income stream, and therefore the Board has time to consider options before selecting a default payout method. It also considers Variable Annuities with GMWB, and states that the eligible participant universe in the first 3 to 5 years after the launch of California Secure Choice is unlikely to have sufficient balances at retirement to afford meaningful income replacement from annuitization, and recommends considering offering this option 3-5 years after launch.

The report does not make the connection between the powerful behavioral impact of automatic enrollment, a default investment option, and automatic escalation during accumulation, and the powerful behavioral impact of selecting a default payout method including guaranteed lifetime income at the inception of the program. In an effort to maximize participation and contributions, the Board should consider offering a default investment that includes guaranteed lifetime income, such as Variable Annuities with GMWB, at the inception of the program, and consider selecting a default payout method at the inception of the program.

To deepen our understanding of participant behavior, Prudential has in the past completed several proprietary research studies, including analyzing our in-force book of business. Our research showed that participants were more likely to "stay the course" when guaranteed lifetime income is part of their retirement plan. We found that plan participants with guaranteed lifetime income were:

- more inclined to stay invested during market turmoil
- better diversified, and
- contributed more than participants without guaranteed income.[5]

Furthermore, to unlock the full potential of lifetime income, plan design plays a pivotal role. We looked at our inforce book of business to see how different combinations of plan design features interact to produce the best participant outcomes, where participation rates were the highest. We found that participation was the highest when automatic enrollment was combined with a default investment that included guaranteed lifetime income. [6]

We once again thank the Board for the opportunity to provide comments on the final report. Please feel free to contact me with any questions concerning these comments.

Sincerely,

Bennett Kleinberg

Bennett Kleinberg
Vice President, Institutional Investment Solutions
Prudential Financial

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[5] See Prudential white paper entitled *Better Participant Outcomes Through In-Plan Guaranteed Retirement Income* at http://research.prudential.com/documents/rp/BetterParticipantOutcomesThroughIn-PlanGuaranteedRetirementIncome.pdf

[6] See Prudential white paper *entitled Guaranteed Lifetime Income and the Importance of Plan Design* at http://research.prudential.com/documents/rp/Guaranteed-Lifetime-Income-and-the-Importance-of-Plan-Design.pdf

March, 2016

The Honorable John Chiang, Chair
California Secure Choice Retirement Savings Investment Board
915 Capitol Mall, Room 110
Sacramento, California 95814

Subject: California Secure Choice Market Analysis, Feasibility Study, and Program Design: Final Report ("Final Report") to the Secure Choice Retirement Savings Investment Board ("California Board")

Dear Treasurer Chiang:

Thank you for your leadership in developing a retirement security program for California workers who currently do not have access to a retirement savings plan.

Generations before us worked tirelessly to uphold their end of the American promise: that the companies they helped to grow would help workers enjoy a secure future. It's the same promise our immigrant workers carried in their hearts when they came to America with the goal of working hard to build a better future for their children.

But in recent years, wave after wave of employers have reneged on that basic contract.

With far too little access to workplace based retirement options, today, three in 10 seniors do not have enough income to cover their basic needs. This situation will only grow worse unless our leaders step forward with solutions.

Like so many hardships facing working people, poverty in retirement does not fall equally across our population. Latinos, African Americans, Asian Americans, women, and workers who haven't been able to build equity in a home are those who face the greatest vulnerability as they enter their senior years.

Here in the Los Angeles area, the future of our seniors will be especially bleak if California leaders don't take action to help our community come together to tackle senior poverty

The good news is that California is on the brink of a breakthrough in tackling senior poverty – if we choose the right path.

The Secure Choice Retirement Board is gathering public input as it decides how to implement a mandate to offer a state-sponsored retirement to 7 million Californians. These are the hard-working people of our state, often in low wage or part-time jobs, who don't have a retirement option where they work. They're bound to join the growing proportion of seniors who live in poverty or work until they die.

Like so many issues of income inequality, the labor community knows that the best option to grow our collective strength is to grow our collective investment. That's why we're calling on the Board to choose the "Pooled IRA with reserve option."

There is only one way to weather even the toughest economic storms—band together and divide risk among millions of workers and across generations. That way no individual bears the brunt of bad timing alone.

Just as workers standing together on the job is the way we've increased wages and eliminated abuses in the workplace, workers investing together is the way to ensure we have a chance to thrive together in retirement.

Scores of workers have been standing up to share stories and ask the Secure Choice board to help them stand with their fellow workers to share risk, and eliminate the uncertainty in a time of extreme anxiety in the financial markets. Remember, it's their future, and the future of millions of Californians like them that is the hands of the Secure Choice board. We urge the Board to select the Pooled IRA with reserve option to secure their future.

Sincerely,

Rusty Hicks
Executive Secretary-Treasurer
Los Angeles County Federation of Labor, AFL-CIO

March 2, 2016

The Honorable John Chiang
California State Treasurer
Chair, California Secure Choice Retirement Savings Investment Board
915 Capitol Mall – Room 110
Sacramento, California 95814

RE: FINAL REPORT OF OVERTURE FINANCIAL TO THE CALIFORNIA SECURE CHOICE RETIREMENT SAVINGS INVESTMENT BOARD

Dear Treasurer Chiang:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is a national trade association which brings together the shared interests of hundreds of broker-dealers, banks and asset managers. Many of our members have a strong presence in California, where they provide services to investors and retirement plans, including advisory services, investment opportunities and plan recordkeeping.

We appreciate the opportunity to provide input to the California Secure Choice Retirement Savings Investment Board ("the Board") as it nears completion of its multi-year study on retirement savings in California and looks to pursue a state run IRA plan for private sector workers. We commend the Board for its commitment to improving retirement savings and for the many hours it has spent examining the issue. We agree that there is a retirement savings challenge in this country and that action must be taken to address this challenge. We, however, respectfully disagree with the report's conclusion that a state run retirement savings plan for private sector workers is an appropriate solution.

As the Board considers the final report from Overture Financial (Overture), SIFMA strongly urges you to take the following into account:

(1) **Access to Retirement Savings**. The market for retirement savings products in California is robust and highly competitive. There are more than 88,000 individuals employed by the securities industry in the state, and more than 550,000 employed in the broader category of finance and insurance. These industries all provide numerous, fairly priced retirement savings options, including 401(k), 403(b), 401(a) and 457(b) plans, as well as SIMPLE, SEP and traditional and Roth IRAs. Where an employer does not provide a plan, IRAs are readily available on-line and at most financial institutions.

We believe that lack of access to retirement savings options may not be the primary reason behind low retirement savings. Indeed, the Overture Report seems to acknowledge that access may not be the issue. On page 27 of the "Online Survey of Employees Without Workplace Retirement Plans" (found at Appendix 5), Overture quantifies that 71% of uncovered workers are in fact already saving for retirement. While Overture states that the average retirement savings rate for these

[1] SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving retail clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. For more information, visit http://www.sifma.org.

workers is 4.5% of household income, 26% are saving between 5 and 9% and 10% are saving an impressive 19% or more. Based on these numbers, it would appear that a state run program would not be filling a coverage gap for most "uncovered" workers. It is simply adding a new savings vehicle to an already robust market.

The question then becomes, "Would this program help the 29% of uncovered workers who are not saving?" Again the Report's online survey raises some questions. For example:

- Fourteen percent of those surveyed strongly agreed with the statement "It is hopeless for me to save anything." This fourteen percent likely makes up almost half of the 29% of uncovered workers who are not currently saving and who, quite frankly, are unlikely to save even with the state sponsored plan.

- Similarly, 14% of respondents somewhat disagreed or strongly disagreed with the statement "I really could save for retirement if I forced myself to do it." Again, these persons are unlikely to save with the state sponsored plan.

- Moreover, 14% of respondents said automatic enrollment with an option to opt-out is a somewhat poor or very poor idea. They presumably would also be unlikely to participate.

It is of course possible that the same 14% answered each of these questions. <u>If that is the case, then 71% of uncovered workers are already saving for retirement and 14% are unlikely to do so. This means that the proposed plan could newly benefit less than 15% of the identified, potential eligible workers</u>. This number could be even lower if the same 14% did not answer each of the above questions.

In short, before developing a complex and costly state run retirement savings structure that competes with the private marketplace, we would encourage you to more fully explore whether this program would assist the 29% of uncovered workers who the Overture report says are not currently saving or would instead simply take people from their existing savings plan and place them in a plan run by the state. We also believe that the study would have benefitted substantially from an analysis of whether education about the existing high quality, low cost options would have had similar impact at substantially lower cost.

(2) <u>**Underlying Obstacles to Saving**</u>. So if access isn't a primary issue, <u>what other factors may be keeping uncovered workers from either saving at all or saving as much as they might like</u>? Again, the Online Survey in the Overture Financial Report seems to shed some light on this issue.

The report says, on page 28 of Appendix 5, "The leading reasons for not saving more for retirement are not making enough money or needing to pay off debts." Indeed, not earning enough, paying off debt, unexpected expenses and a focus on helping family were the top four responses, affecting 74% of all respondents. A state run plan will not change this dynamic. <u>We would encourage the Board to further explore these underlying obstacles before creating a new retirement structure that may not address the real problem</u>.

(3) <u>**Uncertain Regulatory Environment and the Proposed Safe Harbor**</u>. As you well know, the U.S. Department of Labor ("DOL") has issued a proposed rule that would provide states with a

limited safe harbor from ERISA for certain state run retirement savings plans. Sixty-seven entities commented, raising a number of issues that need to be resolved. These include:

- What happens when circumstances outside the control of the State (i.e., the actions of individual employers) violate the terms of the safe harbor?

- Can the safe harbor be extended when the plan does not include employer mandated participation? You raised this concern in your letter to DOL saying, "The Proposed Safe Harbor suggests that such non-mandated employers could cause an entire program to fail the safe harbor and become an ERISA plan, with potentially disastrous consequences for the thousands of participating employers and millions of employees."

- Is the state a co-fiduciary since it is responsible for investing the employee savings or for selecting investment alternatives for employees to choose?

- Why does DOL have a "voluntary" for employees standard in this instance but requires that employee participation be "completely voluntary" in other instances? Is this new standard appropriate?

- Is the safe harbor contingent on the state assuming responsibility for the security of payroll deductions and employees savings? As you noted in your letter, the current language suggests this is the case.

- Is the safe harbor contingent on the state ensuring that employees are notified of their rights and of creating a mechanism for the enforcement of those rights? As you noted in your letter, the current language suggests that is the case.

We would encourage you to wait for DOL's final rule before moving forward with your own recommendation and proposed legislation.

Of course, even with a safe harbor, legal challenges are possible. Labor Secretary Perez himself has recognized the shortcomings of any proposal, stating publicly that "The [proposed] safe harbor is not an air-tight guarantee… The federal courts are the ultimate arbiter on the question of whether state retirement plans are legal or not."

(4) **Employers With Strong Plans May Re-evaluate, Thereby Lowering Overall Retirement Saving**. We also suggest that you consider whether the creation of a state sponsored plan would encourage employers with strong existing plans to drop their current plan in favor of the state alternative. The State is looking to enhance-- not reduce -- retirement saving, and offering options that encourage employers with existing plans to instead enroll in a state offering, with lower permissible contribution levels and no matching funds, would be counterproductive to that objective.

The 2016 Market Feasibility Study conducted by the Connecticut Retirement Security Board found that roughly half of all employers would consider dropping their existing retirement plan in exchange for the state-sponsored option. If even a small percentage of those who would consider dropping a plan choose to go through with it, the results could be devastating to the overall savings rate.

The problem could be further exacerbated if employers with existing savings plans are required to provide access to the state run plan for their part-time workers. Ease of administration may cause these employers to convert everyone to the state sponsored plan, with lower permissible contribution levels and no employer matching funds.

(5) **New Federal myRA** - As you may know, on November 4, 2015, after an almost year-long pilot program and years of careful research and development, the U.S. Department of Treasury launched a new retirement program known as myRA (www.myRA.gov). It is specifically targeted to help low-income workers, small businesses, and those without access to an employer-sponsored retirement program, and it is a simple, safe, affordable, and voluntary way for employees to save for retirement. In the words of U.S. Treasury Secretary Jacob Lew, "myRA has no fees, no risk of losing money and no minimum balance or contribution requirements. To make saving easier than ever, you can now put savings into myRA directly from your bank account." Payroll deduction and tax refund deposits are also available. SIFMA strongly supports the myRA program. Did the Board consider this program before developing a new state alternative, and if not, why not?

(6) **Financial Sustainability**– We continue to work to analyze and digest the Overture Financial report. We appreciate that a lot of time and effort was put into the final product. We would like to take the appropriate amount of time to fully understand and digest it. We, however, do have some initial thoughts:

- The Overture report has estimated the up-front financing costs of the program as somewhere between $79 Million and $129 Million. We would encourage you to compare these costs and benefits to other alternatives, such as investor education, the promotion of myRA accounts, or the development of a voluntary market-based public private partnership, similar to the law enacted in Washington State, which has been fully funded for only $526,000.

- Moreover, these estimates are just that, and are contingent upon the fact that each of the assumptions required to estimate cost prove correct. Some of these assumptions include:

    - The true opt-out rate would have to be roughly 25%;

    - The average income of full-time participants would have to be roughly $45,000;

    - Roughly 1.6 million workers would have to open accounts within the first year (including participants from roughly 30,000 employers with 100+ employees in the first year); and

    - More than 4 million workers would have to sign up within the first few years.

- Furthermore, while the report identifies a little more than 6 million workers who could be eligible, it notes that:

    - the workforce skews young (36% of eligible workers are identified as between the ages of 18 and 29 – and likely includes a large percentage of part-time employees attending school);

- it does not appear to exclude the nearly 750k Californians who work for employers with fewer than 5 employees; and

- 8% of participants could face income restrictions preventing them from participating in a plan (roughly 500,000 workers).

In short, the cost estimate is based on a lot of variables and any miscalculation in a single estimate or assumption could lead to significant cost swings.

(7) **Marketplace Programs**. As you may know, in May 2015, Washington State enacted and funded the first voluntary small business retirement plan "Marketplace" in the nation, which focuses on private providers and myRA and establishes a web-portal structure to connect private sector employers with qualifying plan vendors. A second-in-the-nation Marketplace was established in New Jersey in January 2016. We would encourage you to look at these Marketplace laws to see if their voluntary nature, strong education and outreach components, and low cost/low risk of liability approach are of potential interest before moving forward with a far more costly and comprehensive plan.

Notably, Marketplace programs were specifically highlighted in DOL interpretive bulletin 2015-02, and offer the greatest levels of investor protection and the lowest levels of cost and risk to the state of any option discussed in the bulletin or the proposed, partial safe harbor.

In short, there is a retirement savings problem in California, but we believe that a state sponsored retirement plan for private sector workers is not the answer. We appreciate your willingness to consider our concerns. Please do not hesitate to contact me at 212-313-1311 with any questions.

Sincerely,

Kim Chamberlain

Kim Chamberlain
Managing Director and Associate General Counsel
State Government Affairs

Cc: Members, California Secure Choice Investment Board
Christina Elliot, Acting Executive Director, California Secure Choice Investment Board
Kevin de Leon, California Senate President Pro-Tempore

Celebrating 10 Years
SMALL BUSINESS MAJORITY

March 3, 2016

John Chiang
Board Chair
California Secure Choice Board
915 Capitol Mall
Sacramento, California 95814

RE: California Secure Choice Retirement Savings Program

Dear State Treasurer Chiang:

As a leading representative of the nation's 28 million small business owners and the more than 3.5 million small businesses in California, Small Business Majority is writing to thank you for your continued efforts in implementing the California Secure Choice Retirement Savings Program and making sure the program works for small businesses. Establishing this program will play a vital role in keeping small businesses competitive and helping small business owners and their employees prepare for retirement.

Retirement plans are crucial to employers' ability to attract and retain employees in today's economy. A Towers Watson survey found 63% of workers younger than 40 agreed their retirement program was an important factor in accepting their job in 2011. Unfortunately, too many small businesses lack the resources to set up an employer-sponsored retirement plan. In fact, 77% of the 7.5 million Californians who don't have access to employer-sponsored plans work for small businesses with fewer than 100 employees. Small business owners who can't offer retirement plans due to a variety of barriers know this puts them at a disadvantage in hiring talented workers and keeping their employees happy.

The California Secure Choice Retirement Savings Program offers an easy way for small business owners to solve this problem by offering employees access to a retirement plan, which is why they support this program. Polling from Small Business Majority and AARP found two-thirds of small business owners in California support a state retirement savings program that would help small businesses and their employees save for the future. Nearly three-fourths of respondents think offering such a program would give their business a competitive edge.

Considering the importance of retirement savings for small businesses, we applaud your work in making this program viable for small businesses, particularly your decision to recommend that the U.S. Department of Labor allow auto-enrollment for employers with fewer than five employees.

As you move forward with implementing this program, we encourage you to prioritize small businesses in your decisions, as small business owners and their employees will be key constituents of this retirement program. We also encourage you to consider allowing the self-employed to use the program.

The California Secure Choice Retirement Savings Program offers a tremendous opportunity to help our small businesses. We look forward to seeing the program implemented in full.

Sincerely,

Mark Herbert
California Director, Small Business Majority

February 29, 2016

Treasurer John Chiang
Chair
California Secure Choice Retirement Savings Investment Board
915 Capitol Mall, Room 110
Sacramento, CA 95814

Dear Treasurer Chiang,

The Retirement Equity Lab (ReLAb) at the New School for Social Research supports the proposed Secure Choice Savings plan for California. As some of the original researchers documenting the retirement readiness gap for California's workers, we are long-time advocates of the need for a universal pension plan for all Californians.

The do-it-yourself retirement savings experiment of the last generation has failed. In the late 1970s, it was standard for employees of large firms to have mandatory pension plans. But over the last 45 years, traditional pensions have been replaced by defined contribution plans, or 401(k)-type plans. These accounts are self-directed, commercial, and voluntary retirement accounts that place the burden and risk of managing money on individuals, leaving them vulnerable to the whims of the market. As a result, both coverage and savings have declined to dangerous levels. Forty-five percent of private sector workers across the country don't have access to a retirement plan at work and the median retirement account balance of workers nearing retirement ages 55 to 64 is $12,000.[1]

Combined, low coverage and savings rates define the oncoming retirement crisis. Without adequate retirement income, American workers are faced with losing their standard of living in old age. Specifically, without reform, those in the middle class will face downward mobility as the number of poor or near-poor retirees double in the next decade.[2]

Unfortunately, California's workers are among the least prepared for retirement. Only 50 percent of private sector workers have access to employer-sponsored retirement accounts.[3] That leaves over seven million workers without a viable option for saving for retirement. Not surprisingly, the most vulnerable groups in the labor market are the least likely to have coverage in the workplace. Only twenty-five percent of California's small business employees have access to an employer-sponsored retirement account. Forty percent of Hispanic workers have

[1] Ghilarducci, T., Radpour, S., Fisher. B., and Saad-Lessler, J. (2015) "Inadequate Retirement Account Balances for Workers Nearing Retirement." Schwartz Center for Economic Policy Analysis and Department of Economics, The New School for Social Research, Policy Note Series.

[2] Ghilarducci, T. and Knauss, Z. (2015) "More Middle Class Workers will be Poor Retirees." Schwartz Center for Economic Policy Analysis and Department of Economics, The New School for Social Research, Policy Note Series.
[3] Authors' calculations from CPS

access to an employer-sponsored retirement account. While unionized workers enjoy higher access rates (70 percent) than non-union workers (50 percent), unions represent on 16 percent of California's workforce.[4]

Without access to quality retirement savings vehicles, real people will face their golden years under the threat of deprivation. The real-life consequences of the retirement crisis were recently illustrated in a *Los Angeles Times* story about 79-year-old-retiree Dolores Westfall and her struggle to survive on less than $1,400 a month.[5] Deeply indebted and without a permanent home, Dolores drives across the country in a Winnebago, working odd jobs where she can find them and pinching pennies to survive.

Unfortunately, Dolores' experience is not an exception. In the absence of retirement reform, more Americans will be unable to retire and will have to work into their golden years. Elderly clerks and warehouse workers could become the new normal. *We need to make retirement possible again* by restoring older Americans' option to stop working when they need or want to - without losing their standard of living or facing the specter of poverty. Without effective reform, a swell of impoverished seniors will be unable to retire with dignity and will burden their families and cash-strapped state governments.

The California Secure Choice plan will provide over 4.5 million workers with access to retirement coverage. The plan will increase the share of private sector workers in California with a workplace retirement account from less than half to 80 percent.

While poised for success, the design and implementation details are important to the program's long-term viability and efficacy. Specifically, the California Secure Choice board has proposed two investment options: a target date fund and a pooled IRA with a reserve fund. The pooled IRA with the reserve fund is the best option for two reasons.

First, the pooled IRA will reduce risk in workers' retirement accounts. Pooled accounts allow for diversified investments with longer lifespans. Coupled with a reserve fund, this investment option further reduces the variability of returns by accumulating reserves when returns are high, which can in turn supplement the IRA when returns are low. This "smoothing" function mitigates the current risk workers with defined contribution plans face that their planned retirement date will coincide with a market downturn that wipes out their savings. Research has shown that retirees whose retirement savings are less vulnerable to market swings and who face less risk of outliving their savings experience less stress and anxiety than retirees.[6]

Second, the pooled IRA will generate higher returns than the target date fund. The final report prepared for the board by Overture Financial states that the pooled IRA will generate "superior outcomes in the long run." While some returns will have to go toward establishing the reserve fund at the program's onset, once it is established, the pooled IRA and reserve fund will be able to generate higher returns and replace a greater share of workers income in retirement than the target date fund.

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[4] Union Membership in California - 2014." www.bls.gov. March 5, 2015. Accessed February 23, 2016. http://www.bls.gov/regions/west/news-release/unionmembership_california.htm.

[5] Glionna, John. "Too Poor to Retire and Too Young to Die." *LA Times* (Los Angeles), January 29, 2016. Accessed February 23, 2016.

[6] Panis, Constantijn (2003) "Annuities and Retirement Satisfaction." Labor and Population Program Working Paper Series 03-17, Rand

All California's workers need an effective way to save money for retirement. Experience shows that automatic savings in a pooled investment with a possibility of annuities is the best and cheapest way to guarantee income for life.[7] We strongly recommend the Board and legislature implement the Secure Choice Savings Act and use a pooled IRA with a reserve fund to invest accumulated savings.

Sincerely,

Teresa Ghilarducci
Director, Retirement Equity Lab (ReLab)
Professor of Economics
The New School for Social Research

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[7] Aon Hewitt (2015) "Custom DC Investments for Participant Success"

Good Afternoon. My name is Tonia McMillian, and I'm a child care provider in Bellflower.

I'm also the Treasurer of SEIU Local 99, Education Workers United and the Co-Chair of the Raising California Together coalition.

I'm here today to urge the Board to create a strong system that will allow private sector workers like me to retire someday. I urge you to adopt a <u>pooled IRA with a reserve</u>, which will ensure a stable fund that provides the greatest return and the lowest risk for low-income families.

Unless I can benefit one day from an investment fund like this, having some security or a little piece of the American Dream is completely out of reach for me.

As it stands now, I will have to work until I die. The average Social Security benefit for women over 65 is just slightly above poverty level—about $13,000 per year. I have no idea what my future's going to look like.

What little extra money I've had, I spent on my children and on continuing my education. Our economy today just doesn't work for ordinary working people. When you consider that family child care providers like me working a 50 hour week earn about $4.98 and hour and compare that with the costs of college, healthcare and just basic living expenses…well, it becomes clear that I will never catch up in time to afford any kind of retirement.

Please know that the decisions you make about this fund will profoundly affect low-wage women of color like me.

I know a few people who worked for the school district and have pensions. When I see them, I feel like I'm left out. I am a child's first teacher and the children in my care consistently end up in the top kindergarten classes. I've dedicated my career investing in children's lives—just like my friends at the school district. But no one invested in my life. I worry about it every day.

Sadly, I think I have to find a new career. I just enrolled in a program to earn my B.A. in business. By the time I get my degree, I'll be almost 60. I know I'll have to compete with younger workers, but I'm determined. While I look forward to this challenge, I look beyond it with anxiety and dread. I see no possibility of retirement, and I don't want to—and may not be able to—work until I die.

Warehouse Union Local 6
INTERNATIONAL LONGSHORE & WAREHOUSE UNION
99 HEGENBERGER ROAD, OAKLAND, CA 94621-1485 • (510) 638-5605 • 1-800-864-8302 • FAX: (510) 638-3297

March 2, 2016

To: The Secure Choice Board,

My name is Fred Pecker. I am the Secretary Treasurer of Local 6 of the International Longshore and Warehouse Union. Our Local has members in warehousing, manufacturing, waste disposal, recycling, and health care.

Our Union has works to provide security for our members and have participated in campaigns to insure a living wage jobs in the areas our members live. With the crash of the financial markets in 2007-2009 our members have become painfully aware of the importance of secure retirement plans. Workers need retirement security and a new and improved ways to save for the future, in a secure manner. There is a need for retirement plans which minimize the damage of a poorly regulated Wall Street.

All workers, but especially low wage workers, need a retirement investment option **that reduces risk, smooth out market losses, and helps ensure consistent benefits.** I am writing in supports the pooled fund option with a reserve.

For some workers this will be a low impact means of supplementing negotiated pension plans. For many is will provide a way to create a benefit parallel to the Social Security benefit that provides people / us the means to live (and hopefully enjoy) the years after we complete our working lives. .

I encourage you to pick the **Pooled Fund Option with a Reserve.** Thank you.

Sincerely,

Warehouse Union Local 6, ILWU

Fred Pecker

Fred Pecker, Secretary Treasurer