OCTOBER 19, 2020

AGENDA ITEM 5
ACTION ITEM

CALSAVERS RETIREMENT SAVINGS BOARD

Third Quarter Investment Performance & Discussion of Default Investment

Part I: Third Quarter Investment Performance

Consultants from Meketa Investment Group ("Meketa") will present a review of third quarter performance (Attachment 5A).

Part II: Default Investment

Background

The Program's existing default investment, as established in the investment policy statement, prescribes that the first $1,000 of participants' contributions are directed to the Capital Preservation Fund option, composed of the State Street Institutional U.S. Government Money Market Fund (GVMXX). Subsequent contributions under the default scheme are directed to a Target Retirement Fund based on the participant's age. Both of these funds are managed by State Street Global Advisors.

The Board selected this default scheme as a way to provide a modest cushion of liquidity for participants in their early months of participation and to support participants who may choose to opt-out and seek to withdraw their funds in the first months of participation.[1]

The total fees for participation in this option are 0.92% (the equivalent of 92 cents per $100 per year), composed of the following three fees:

0.05%	State Administrative Fee
0.12%	Underlying Fund Fee (State Street Global Advisors)
0.75%	Program Administrator's Fee (Ascensus)
0.92%	**Total Fee**

[1] As a point of context, CalSavers' peer program in Oregon has a near identical default investment scheme. The peer program in Illinois, by contrast, defaults the first 90 days' contributions into a money market holding fund and then sweeps all assets into a target date fund, where all future contributions are directed.

Impact of Recent and Expected Near-term Performance: Fees Exceed Yields

With the onset of zero or near zero percent interest rates earlier in 2020, the CalSavers Money Market Fund option has experienced negative performance net of all fees, as shown in Meketa's quarterly performance report (Attachment 5A).

As reported in recent Board meetings, State Street Global Advisors is temporarily waiving its fee or a portion of its fee as necessary to ensure performance of the underlying money market fund does not fall below zero. However, the remaining administrative fees pose a challenge. This is of particular interest to the Board because of general expectations for stability of principal in money market funds or "capital preservation" type options, even though no performance guarantees are ever provided by the Board or its investment managers.

To address this challenge, the Board is currently ensuring that participants in the money market fund do not experience negative performance net of fees by directing the program administrator Ascensus to effectively cover the difference using funds it had originally committed to use primarily for marketing expenditures for CalSavers. This is intended to be a temporary measure to support participants while the Board explores other options. Through October 9, 2020, a total of $16,907 had been reallocated from marketing purposes to cover this cost.

Analysis and Options

Continuing to implement this solution would likely consume more of the Ascensus marketing budget than the Board is willing or able to divert, given the expectations that low interest rates will continue into 2022 and CalSavers will grow exponentially over the same timeframe. In fact, if CalSavers grows at just approximately the expected rates, even the entire Ascensus marketing budget would not cover the cost of this solution in the next few years.

In addition, failing to sufficiently promote the Program and reach out to employers would lead to slower overall growth and, in turn, a longer timeframe for reaching asset-based breakpoints for fee reductions that solely benefit participants.

At the direction of staff, in the spring and early summer Meketa conducted a sweeping review of alternatives to the Money Market Fund (Attachment 5B). In addition, staff explored the possibility of potential internal management through one of the funds managed by the State Treasurer's Office.

Based on the limited options resulting from those initial reviews and direction from the Board during the July meeting, Meketa conducted a quantitative analysis of cost of continuing to implement the current the solution in addition to a narrow set of alternative policies. The results of Meketa's analysis are contained in Attachment 5C.

The primary options include:

1) Status Quo: Keep the Money Market Fund as the default investment option for the first $1,000 and continue to support performance by diverting marketing dollars from the Ascensus budget.

2) Keep the Money Market Fund as the default investment option for the first $1,000 but do not support performance and allow participants in this fund to experience negative performance net of fees.
3) Change the default investment option to:
    a) Contributions for the first 30 days are directed to the Money Market Fund, then on day 31 all funds are swept into the appropriate Target Retirement Fund where all new contributions will be directed.
    b) Same as a) but sweep at 60 days, 90 days, 180 days, or some other point in time.

Operational Considerations and Timing

Any of the options outlined above could be applied to the entire population of existing and new participants or only to new participants. The former scenario in which the change would be applied globally would be substantially simpler and less costly to implement from an operational standpoint. Under the latter scenario in which existing participants would be "grandfathered," implementation complexities and costs would be substantial and would further delay the implementation of the change.

Any change in the default investment scheme would require substantial legal and operational changes, including:

- Regulations updates;
- Investment Policy Statement revision;
- Contract amendments for affected vendors;
- An extensive array of technical/programming changes to the record-keeping platform;
- New notices and disclosures to existing participants (assuming no "grandfathering");
- Materials revisions, including disclosures, brochures, notices, webpages, and other educational content.

If the Board chooses to change the default investment option, implementing the change as soon as is feasible during this period of growth would minimize the number of affected accounts and, in turn, the complexity of the change. Staff would present the amended documents to the Board for approval at the next Board meeting.

Staff Recommendation

Staff recommend the Board authorize the Executive Director to develop proposed amendments to the documents noted above to change the default investment to option 3a above (whereby contributions for the first 30 days are directed to the Money Market Fund, then on day 31 all funds are swept into the appropriate Target Retirement Fund where all new contributions will be directed).

Attachments

- Attachment A: Meketa Presentation on Q3 Performance
- Attachment B: Meketa Memorandum to the Executive Director on Alternatives to the Money Market Fund
- Attachment C: Meketa Analysis of Options for New Default Investment