



STATE OF CONNECTICUT

# RETIREMENT SECURITY BOARD

CO-CHAIRS: STATE COMPTROLLER KEVIN LEMBO & STATE TREASURER DENISE NAPIER

Connecticut Retirement Security Board

Meeting Minutes

Wednesday, November 4, 2015

8:30 A.M.

55 Elm Street, Hartford, 7<sup>th</sup> Floor Treasurer's Conference Room

## Members Present:

Hon. Kevin Lembo, State Comptroller, Co-Chair

Hon. Denise Nappier, State Treasurer, Co-Chair

Michael Callahan

Ken Floryan

William Kosturko

Brendan Maher

James Russell (via phone)

John Sayour (via phone)

George Kasper

Sal Luciano

Jamie Mills

## Members Absent:

Thomas Barnes

Commissioner Sharon Palmer

## Special Guests:

Rashid Hassan, Mercer Consulting

Neil Lloyd, Mercer Consulting

Bradley Kellum, Oliver Wyman

Joshua Applebaum, Oliver Wyman

Michael Kreps, Groom Law Group

Ernest Lorimer, Finn Dixon & Herling

## Other Participants:

Genevieve N. Ballinger, Research Analyst, Office of the State Comptroller



### **A. Call to Order**

Comptroller Lembo called the meeting to order at 8:33 a.m.

### **B. Adoption of September 25, 2015 Meeting Minutes**

A motion was made by Ken Floryan to adopt the Meeting Minutes of September 25, 2015. Sal Luciano seconded the motion. The minutes were adopted unanimously at 8:33 a.m.

### **C. Adoption of October 16, 2015 Meeting Minutes**

A motion was made by Sal Luciano to adopt the Meeting Minutes of October 16, 2015. George Kasper seconded the motion. The minutes were adopted unanimously at 8:34 a.m.

### **D. Timeline Overview**

Comptroller Lembo explained to the Board that the Boston College Center for Retirement Research (CRR) will be sending its final report this week for the Board's review. Comptroller Lembo asked that the Board forward any comments to Genevieve Ballinger prior to the next meeting on December 2. He also explained that the Board would need to make some decisions on recommendations today, including the type of Individual Retirement Account (IRA) offered, the default option for distribution at retirement, the default contribution rate, and the program structure and enforcement. Mercer will continue to work with the legal team and should have its final report to the Board by mid-November.

### **E. Market Feasibility Study Update**

#### Mercer Consulting

Rashid Hassan from Mercer Consulting presented on the considerations in assessing the type of IRA to be offered. He highlighted the restrictions and penalties on withdrawals, the tax effects, and the access to accumulated savings. Roth IRAs allow access to principal during the accumulation phase, which could be viewed as positive for those who need it or negative for those who use the retirement account more like a savings account. Roth IRAs can only be rolled into other Roth IRAs, not into any other type of retirement account. Traditional IRAs result in a greater amount of take-home pay because the contributions are pre-tax. Michael Callahan asked who would monitor the Roth contribution amounts to ensure the contributions did not exceed the contribution limits and to ensure the participant's income was not high enough to make the participant ineligible to contribute to a Roth. Mr. Hassan suggested that members would likely need to self-identify because of the administrative complexity of relying on employers. He also brought up an EBRI study that found lower income households preferred the tax benefits of a Traditional IRA. However, the survey completed by CRR did not find a preference for Roth or



Traditional IRAs. Mr. Callahan asked if low income participants still receive a tax credit with an IRA. Mr. Hassan explained that they do, with a maximum of \$1,000 and an average of \$126.

Mr. Hassan explained that since income generally rises with age, in order to provide the best option for the broadest section of the uncovered population, the Roth IRA should be the default. Most of the participants would benefit from taxes being incurred at a lower tax bracket, since the younger workforce is the biggest part of the target population. However, the Board could also choose to offer both types of IRAs. Mr. Floryan suggested that the implementing Board be given the flexibility to make the final decision, but that he would recommend to them that the default be the traditional IRA due to ease of implementation, higher take-home pay, and discouraging early withdrawals. William Kosturko agreed that the implementing Board should have flexibility because we do not know how federal IRA tax policy will change in the future. Jamie Mills explained that she was concerned that the penalty on early withdrawals would unfairly punish people who are in need of their own money. She would not want to encourage people to withdraw early, but would not want to punish those in desperate need of the money either. Mr. Kasper responded that Traditional IRAs do have hardship exemptions for early withdrawals. Comptroller Lembo also indicated, however, that those hardship exemptions are likely linked to an onerous process.

Ernest Lorimer from Finn Dixon & Herling explained that since the legislation does not require the Board to choose the type of IRA, that it may be problematic to bind the implementing Board's hands at this point. Michael Kreps from Groom Law Group explained that he was involved in this same conversation at the federal level with respect to the federal Auto-IRA proposal and the myRA. He explained that the Roth was chosen for some policy reasons such as the lack of penalties and the population's higher need for early withdrawals, but mostly for the lesser impact on the federal budget. A motion was made by Mr. Floryan to recommend offering both Traditional and Roth IRAs and using the Traditional IRA as the default option, but that the legislature should give the implementing Board the authority to make the final decision. Treasurer Nappier seconded the motion. James Russell explained he believed they should not offer options to participants because they are not knowledgeable enough to choose. The motion passed unanimously at 9:34 a.m. Mr. Russell abstained. Mr. Luciano asked that Mercer include an explanation of the Saver's Credit in the report.

Mr. Hassan described Mercer's recommendation with respect to distribution at retirement. Mercer's recommendation is that the decision be left to participants and that annuities be included as an option, but not be the only option at retirement. He also explained that the default should be something that is easily reversible, like systematic withdrawals. Brendan Maher explained how choice-driven strategies have historically been unsuccessful and that he doubted Mercer's assumptions of costs of annuities. He also explained that systematic withdrawals are very similar to annuities, just without the longevity insurance. Neil Lloyd from Mercer described that annuities have a perception of being expensive, but agreed that mandating an annuity for all participants may decrease the costs. He also explained that when participants actually have



money in their accounts, they have much higher engagement with the program at distribution than they do in the accumulation phase. Mr. Callahan explained that existing providers in the 401k world have begun to offer annuitization features that are built into the investment product and that the lifetime income products are rapidly changing. Treasurer Nappier asked if they could provide a hybrid system, with a default but offering other options as well. Mr. Floryan recommended the default be the option that works for the majority of people. Mr. Luciano explained that without an annuity, the program does not increase retirement security but just provides a savings plan. Mr. Callahan also described the benefit that creditors cannot go after a total balance when a participant has an annuity, but can only go after the monthly payments. John Sayour stated that unless significant education and training is provided to participants, then simplifying the plan is crucial.

A motion was made by Mr. Floryan to recommend that 100% of participants' account balances be defaulted into an annuity, but that the implementing Board would have the authority to make the final decision. Mr. Callahan seconded the motion. Mr. Lloyd explained that a 100% requirement would mean changing your investment strategy. Treasurer Nappier asked about the definition of at retirement. Mr. Maher suggested that the definition be left to the implementing Board to decide. Mr. Floryan withdrew his motion at 10:29 a.m. Ms. Mills asked if the Board wanted to recommend a mandatory annuity rather than a default annuity. Mr. Maher recommended 50% of participants' contributions be mandatory annuity and 50% be default annuity. Mr. Floryan explained that portability is still maintained by allowing participants to roll their money over into another IRA. A new motion was made by Mr. Floryan to recommend that at retirement an annuity be mandatory for 50% of participants' account balances, while the remaining 50% is defaulted into an annuity, but that the implementing Board would have the authority to make the final decision and could also decide whether or not multiple options are offered as an alternative to the 50% default. Mr. Luciano seconded the motion. The motion passed unanimously at 10:38 a.m.

#### Oliver Wyman

Bradley Kellum with Oliver Wyman presented on the results of the feasibility modeling study. He explained that the program should be self-funding, attractive to service providers, and attractive to participants. He believes it will be very attractive to service providers based on the potential size of the program. Mr. Kellum explained that implementation could take up to six months and cost in the low millions. He used 50 basis points as a starting point for initial cost to the program based on the standard in the 529 market. The 50 basis points would be divided up likely with 20 basis points going to the investment manager, 20 – 25 basis points going to the IRA administrator and depository/custodian, and 5 – 10 basis points going to the governing body. Assuming a 5 – 10 basis points fee for the governing body and \$500K to \$1MM in ongoing administrative expenses, the program would need \$1BN as the minimum asset threshold to be viable. The governing body will want to repay set up costs and cover ongoing expenses as soon as possible. Third party providers have indicated willingness to cover some of the upfront



program setup costs, but the implementing Board will need to cover about \$1MM – \$2MM for upfront administrative costs.

The key drivers for building program assets are participation rates and contribution rates. In the base scenario, program assets are estimated to meet the minimum asset threshold by the end of year two. Around years five to seven would be the critical point for renegotiating fees with the third party service providers. The feasibility was also tested with several extreme downside scenarios, including an employer non-participation rate at 48% as was found by CRR's employer survey, annualized returns at less than 3%, double the assumed leakage rates, unemployment at the highest rate since 1976 at 9.3%, and a significant market correction in each of years one through seven where 20% of the population exits the program and the entire population decreases their contributions from 6% to 3%. In these extreme downside scenarios, the minimum asset threshold is reached between years five and seven. The governing body can take some mitigating actions to prepare against these potential downsides, including offering education, reaching out to those who have opted out of the program, providing employer outreach and education, increasing fines for employer noncompliance, or increasing program fees upfront to decrease the required minimum asset threshold. The takeaway is that the program seems to have the potential to be very lucrative, which means costs to participants could be driven down to low levels. The mandatory feature of the program is the key component driving the asset collection.

Ms. Ballinger asked the Board to discuss the 6% default contribution rate. Mr. Floryan stated that he did not believe 3% would get the participants to retirement security. The Board's market analysis study suggested there would be no difference in opt-out rates with a 3% or 6% default contribution rate. Mr. Callahan explained that 6% was a lot of money out of this population's checks and that 3% is the more realistic amount. A motion was made by Mr. Floryan to recommend that participants be defaulted to a 6% contribution rate, but that participants could elect a different rate. Mr. Maher seconded the motion. The motion passed with a majority vote at 11:20 a.m. Mr. Callahan voted nay. Mr. Russell abstained.

### Legal Team

Mr. Kreps from Groom Law Group presented on the structure and enforcement of the program. First, he explained that the IRA structure abides by the ERISA restrictions and would likely not be preempted. However, it will ultimately be decided by the courts. The U.S. Department of Labor will issue a proposed regulation by the end of the year that is expected to exempt state-sponsored auto-IRA programs from ERISA. Mr. Lorimer from Finn Dixon & Herling explained the legal team's recommendation that the program be placed in a new quasi-public state agency. He explained that officials in such agencies are generally subject to state indemnification for liability. Comptroller Lembo indicated that he could only support a quasi-public state agency structure if there were strong transparency and freedom of information requirements included in the agency's statute.



Mr. Kreps then described the recommended consumer protections. He explained that the legal team would recommend placing a high standard of care that mimics ERISA, the “best interest” fiduciary standard of care, on the Board members and service providers. In order to limit the costs to the State, he suggested limiting enforcement to remedies that change future actions but limit past damages. He also suggested creating a channel through a state agency, such as the State Attorney General’s office, for all claims. This way, a state agency provides oversight to keep the governing body and service providers accountable. Ms. Mills asked about Board insurance. Mr. Kreps responded that insurance is an option and that it is relatively inexpensive, but that in a big plan like this, the payout could be extremely large. Treasurer Nappier explained that existing state fiduciary entities may have templates already existing that we can easily follow.

Mr. Kreps then explained that there would also have to be systems in place to keep employers accountable with respect to remitting participants’ contributions. He stated that protections already exist in federal law that we can use. Enforcement can be by private action or by state action and possibly even criminal prosecution, similar to wage theft laws. There also needs to be a mechanism for enforcing the auto-enrollment requirement. In this area, a bigger penalty equals better compliance. The legal team recommends making it very simple for employers to comply and to allow them to self-report under penalty of perjury. The State would also need discretion to waive penalties for any honest mistakes. Mr. Floryan suggested that the statute include a ban on pressuring employees to opt out, which would likely depend on whistleblower complaints.

## **F. Financial Report**

Comptroller Lembo shared with the Board that Pew Charitable Trusts had given a gift of \$50,000 toward the financial feasibility study.

## **G. New Business**

Comptroller Lembo explained to the Board that Joshua Gotbaum from Brookings offered to present to the Board on providing an ERISA covered plan. Comptroller Lembo would recommend delaying the invite until after January, since we have competent legal counsel and not enough time for another presentation before then. Mr. Kasper agreed that it would make sense to delay the presentation until the U.S. DOL announces the language of their forthcoming guidance. Mr. Callahan would like the Board to consider the issue of uncashed checks and what procedure would be used to ensure an appropriate process is followed. He was also concerned about the public perception around the 6% default contribution rate. Treasurer Nappier agreed that the Board should be sensitive to public perception when presenting their recommendations and should explain how the 6% contribution rate best meets the stated goal of obtaining retirement security. Mr. Floryan suggested holding a presentation before the legislature on the final feasibility report and recommendations. Mr. Kosturko emphasized that the 6% is only the default, but that they have other options.



### **H. Public Comment**

There was no public comment.

### **I. Adjournment**

A motion was made by Mr. Luciano to adjourn. Mr. Floryan seconded the motion. The meeting adjourned at 12:09 p.m.