



**Kate Kiernan**  
Vice President, Chief Counsel & Deputy, State Relations

**Statement of the American Council of Life Insurers  
to the Connecticut Retirement Security Board  
Thursday, November 13, 2014**

Chairs Nappier and Lembo, and members of Connecticut Retirement Security Board, thank you for the opportunity to provide you with our thoughts on the proposed feasibility study to explore the development of a state-run private sector retirement plan.

The American Council of Life Insurers (ACLI) is a national trade association with approximately 300 member companies operating in the United States and abroad. 228 member companies serve Connecticut consumers. ACLI advocates in federal, state, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers' products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance and represent more than 90 percent of industry assets and premiums in Connecticut.

One point that has been driven home by comments offered in Connecticut and other venues is that the root cause for lack of retirement savings is behavioral at the individual level. Debt, job insecurity, and lack of income are just a few of the reasons consumers themselves give for not saving for retirement. Retirement saving is a voluntary choice and can be a sacrifice. Even those with the means to save for retirement struggle with the delayed gratification of doing so. A simple example of this is the 457(b) plan offered to Connecticut state employees. Even with a very simple method for employees to dedicate part of their pay to the 457(b) plan and, thereby, increase their savings for retirement, the state struggles to motivate employees to contribute. The challenge is even greater for the state to manage a similar plan for private sector workers.

**Connecticut Retirement Security Board**

Over the last several decades, the defined contribution (DC) system in the United States has grown and evolved to better meet the needs of employers and participants. According to the U.S. Department of Labor's Bureau of Labor Statistics, almost 80% of full-time workers have access to employer-sponsored retirement plans, and more than 80% of workers with access to plans participate. When one includes all part-time and seasonal workers, 68% have access to employer-sponsored retirement plans, and 79% of workers with access participate. DC plans now comprise the majority of these plans, and IRA solutions are available for those who do not have access to an employer-provided plan.

In short, the current retirement security system works well. However, there is always room for improvement. More can and should be done to encourage employers to offer plans to their employees. As an industry that is committed to helping people prepare for long retirements, life insurers are prepared to help you find solutions within the current private sector system to achieve this goal.

## **Request For Information (“RFI”) Issues:**

### **Plan Design**

Employers today have a number of affordable options to design a benefit program to suit their need. Many of these plan types were created with the needs of small employers in mind. The private sector offers a wide range of products and services to implement and support these plans. The Board should review these plans and consider the various product options currently available to employers. It should also consider the costs and risks of these plans and how the costs and risks will apply to a state run plan. Therefore, a comprehensive current market study, as required in the legislation, should be the key focus of the RFI. We believe that such a review will show that a separate state run plan is unnecessary and that the state providing such a plan without significant risks and liabilities to the state is impossible. In addition, the request for comment seems to overlook the fact that if the feasibility study recommends against a public retirement plan than step 2, development of the plan, should not proceed. Thus the RFI should be amended to clearly reflect the two-stage process.

### **Investments**

Many qualified retirement plans and IRAs offer guaranteed fixed returns under binding contracts issued by insurance companies. Regarding a state operated guaranteed fund, note that individual retirement accounts must pass through all gains and losses of the account holder’s investments, including guaranteed fixed returns, to the account holder. The Board should confirm, and therefore the RFI should include, consultation with the IRS and Treasury that, under the Internal Revenue Code, the custodian/trustee of an individual account plan must fully allocate the earnings and losses of the trust to the individual accounts each year.

As for the purchase of insurance to provide a “guaranteed return,” absent the use of guaranteed fixed return contracts, Connecticut may find it difficult and/or costly to hedge its bond, equity and other investments against losses and/or to purchase insurance to guarantee the rate set by the Board. In its analysis of a similar proposal in California, the New America Foundation notes that the cost of hedging these investments, if such hedging is available, will require the board to “credit” an even lower rate to workers’ savings. If it is determined that the Board could offer such a program, the RFI must consider and address what party or parties will make worker accounts whole should the guaranteed rate exceed both the trust’s gains and the limits of its hedging and insurance.

### **Legal Issues**

Regarding whether “the public retirement plan” will be treated as an employee benefit plan under Employee Retirement Income Security Act (ERISA), a federal law enacted to protect the interests of private sector workers and their beneficiaries, the Board should request from the U.S. Department of Labor an Advisory Opinion as to whether a plan is subject to Title I of ERISA. If a state plan for private workers is subject to ERISA, as all other such private plans are, then there will be fiduciary responsibilities and compliance requirements imposed on the plan sponsor and participating employees.

While an Advisory Opinion from the Department does carry weight, workers may still seek the enforcement of ERISA rights in federal court. More questions regarding the work of examining ERISA coverage and employer liability should be addressed in the RFI.

The Board may request the Department of the Treasury to grant the Board custodial authority to operate individual retirement accounts. In its filing with the IRS and Treasury, the Board should also confirm the extent to which the plan and parties to the plan are or are not exempt from the tax imposed on

prohibited transactions under Internal Revenue Code §4975. The work of examining this issue should be addressed in the RFI.

No mention is made in the RFI of the application of federal securities and/or federal/state banking law to this plan and trust. The Board should determine the extent to which the arrangement is subject to registration with the Securities and Exchange Commission, what other requirements of federal securities law apply, as well as the application of banking law, if any, to the arrangement. The work of examining this issue should be addressed in the RFI.

### **Costs**

The questions on cost and fees in the RFI seem to focus on reduction of administrative expenses. A threshold question must be how much a plan of this design will cost both the State of Connecticut and employers. Attached to our comments are fiscal impact statements from California, Maryland and a white paper from Milliman estimating the administrative costs of a state run defined benefit plan. The California Department of Finance estimated that a state run program could cost \$1.2 million in administrative and operating costs in the initial start-up years. The California fiscal impact statement also pointed out that if the program was found to be subject to ERISA, then the state would have to make significant payments to the Pension Benefit Guaranty Corporation (PBGC) estimated at 1 percent of program assets. Lastly, the Milliman white paper gives a variety of scenarios but estimated that a California state run defined benefit plan would cost \$775,000,000 annually.

### **Conclusion**

As a final point, the life insurance industry is uniquely situated to assist the state in their study and to help Connecticut consumers plan for their retirement. ACLI member companies offer insurance contracts and other products and services to employer sponsored retirement plans and to individuals through IRAs and non-qualified annuities. ACLI member companies also are employer sponsors of retirement plans for their own employees.

In Connecticut alone, retirement plans, IRAs and annuity products are available from such ACLI member companies as:

AIG Life and Retirement  
Allianz  
Ameriprise Financial, Inc.  
Ameritas  
Amica Life Insurance Company  
Assurity Life Insurance Company  
AXA Financial  
Country Companies  
CUNA Mutual  
EMC National Life Insurance Company  
Federal Life Insurance Company (Mutual)  
Federated Life Insurance Company  
Fidelity & Guaranty Life Insurance Company  
Foresters  
ING U.S.  
Lincoln Financial  
Lincoln Heritage Life Insurance Company  
John Hancock (Manulife Financial)

MassMutual  
MetLife  
Securian  
MTL Insurance Company  
Mutual of America Life Insurance Company  
Nationwide Financial  
Ohio National  
Oxford Life Insurance Company  
Pacific Life  
Penn Mutual  
Principal Financial Group  
Reliance Standard  
Sammons Financial  
Sentry Life Insurance Company  
Standard Insurance Company  
The Guardian  
Thrivent  
Torchmark  
Transamerica Corporation

Thank you for consideration of our comments. Please contact Kate Kiernan at 202-624-2463 or [katekiernan@acli.com](mailto:katekiernan@acli.com) or John Larkin at (860) 430-5928 or [john@jclarkin.com](mailto:john@jclarkin.com) with any questions you may have on the vibrant private sector retirement market in Connecticut.

## STATE-RUN RETIREMENT PROPOSALS

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### BACKGROUND

The private retirement system provides a robust and growing foundation for retirement security through defined contribution plans, IRAs, and individual annuities. Employer-sponsored retirement plans offer more than 83 million American workers and their families the opportunity to accumulate savings and improve their retirement security.

Recently, some states have proposed government-run retirement programs to accommodate those without access to a workplace plan. These proposals largely ignore the wide array of products and services currently available from financial services providers and would impose significant costs and liabilities on states, employers, and taxpayers.

### Significant Costs and Liabilities for States

Currently, many states are already struggling to meet the obligations of state employee pension plans and other large government programs. New government-run plans for private sector employers would add to this burden. A state-run retirement plan would:

- Cause uncertainty for small businesses. Under proposed legislation to create new government-run retirement programs, employers could face significant operational costs and be subject to fiduciary responsibilities. Some legislation mandates employers to participate in state plans while other legislation mandates employer contributions to state plans.
- Be costly to set up and implement and would create an ongoing expense and liability for the state and taxpayers. A study authored by the Maryland Supplemental Retirement Plans (MSRP) concluded that a state-sponsored voluntary accounts program would require significant long-term state expenses. Furthermore, a 2009 Washington State report estimated that a state-sponsored basic IRA plan would have start-up costs of \$1.8 million and annual on-going state costs of almost \$1.4 million.
- Be subject to the Employee Retirement Income Security Act (ERISA). All retirement plans for private sector workers must adhere to the complex requirements set by federal law—including ERISA and IRS rules. Workers benefit from these important protections, while employers and plan sponsors have strict compliance and fiduciary responsibilities. Therefore, once a plan is established, a state and any participating employer would incur ongoing operational, oversight, compliance, and insurance costs associated with these rules.

### Access to Retirement Savings Plans

There is a misguided notion that there is a lack of access to retirement plans in the private sector. Today, nearly 80 percent of full-time workers have access to a workplace retirement plan, and more than 80 percent of workers with access participate. IRAs and individual annuities are available for 100 percent of workers without access to employer-sponsored plans as well as to supplement retirement savings. To help more Americans prepare for retirement, public policy solutions should make it easier for small employers to offer plans and for workers to boost their savings rates.

President Obama's new "myRA" plan, managed by the U.S. Treasury, is expected to be operational in 2015, and will be another option for families to save for retirement with as little as \$5 a month. States should not take on a new financial burden when a new option will be available to help all workers.

### **Existing Private Retirement Marketplace and Subsidizing State Plans**

With an existing competitive market among private providers of portable retirement solutions, state-run retirement plans are unnecessary. States should not use funding, regardless of the source, to compete with private providers of 401(k) plans, 403(b) plans, 457(b) plans, IRAs, and other retirement options.

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#### **STATUS**

No state has implemented a state-run retirement plan due to the staggering costs to state budgets, the complexity of implementation, and the burden on employers. Since 2012, California, Connecticut, Vermont, and West Virginia have passed legislation to study the feasibility and costs associated with state-run pension programs for private sector employers. Several other states, including Maryland, Minnesota, and Oregon are studying how to increase retirement savings in their states. ACLI is acting as a resource in all of these studies.

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#### **ACLI POSITION**

The costs and risks associated with state-run retirement are unnecessary. Public policy should make it easier for small employers to offer workplace savings opportunities by limiting administrative burdens on employers. ACLI supports extending the federal "savers credit" to state personal income tax, targeting lower and middle income brackets. ACLI supports states offering a business tax credit for new retirement plan formation. States also should encourage participation in President Obama's new "myRA" plan.

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#### **AT A GLANCE**

- Employer-sponsored retirement plans offer more than 83 million American workers and their families the opportunity to accumulate savings and improve their retirement security.
- Eighty percent of full-time civilian workers have access to a workplace retirement plan, and more than 80 percent of workers with access participate. IRAs and individual annuities are available for 100 percent of workers without access to employer-sponsored plans as well as to supplement retirement savings.
- Millennials (those born from 1979 to 1991) show high levels of enthusiasm and confidence for 401(k) plans. Eighty-three percent of millennial participants made recent contributions to a 401(k) plan, higher than people of a similar age a decade earlier. Millennials who took advantage of guidance also have increased their average deferral rate from 4.5 to 8.7 percent of salary or wages over the past decade.

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## KEY FACTS AND FIGURES: THE STRENGTH OF THE PRIVATE RETIREMENT SYSTEM

The private retirement system is strong and serving millions of Americans, providing the foundation for financial and retirement security through defined contribution plans, IRAs, and individual annuities. The industry is committed to working with policy-makers to advance balanced solutions to expand access and increase savings to help even more American families.

### Access and Participation

- Nearly 80% of full-time workers have access to a workplace retirement plan, and more than 80% of workers with access participate.<sup>1</sup>
- Employer-sponsored retirement plans offer more than 83 million American workers and their families the opportunity to accumulate savings and improve their retirement security.<sup>2</sup>
- A study by the Employee Benefit Research Institute finds that among low and moderate income workers, 71% are more likely to save for retirement when an employer has a plan.<sup>3</sup>
- IRAs and individual annuities are available for all workers without access to employer-sponsored plans as well as to supplement retirement savings.

### Contributions

- Participants are generally contributing 5-7% of salary to 401k plans, and when employer contributions are added to employee contributions, the median contribution rates are around 10% of salary.<sup>4</sup>
- Millennials (those born from 1979 to 1991) show high levels of enthusiasm and confidence for 401(k) plans. 83% of millennial participants made recent contributions to a 401(k) plan, higher than people of a similar age a decade earlier. Millennials who took advantage of guidance have also increased their average deferral rate from 4.5% to 8.7% of salary or wages over the past decade.<sup>5</sup>

### Mobility

- While not required to do so, a majority of plan sponsors allow immediate eligibility in their 401(k) plans with no service requirement for their workers (with this trend increasing over time).<sup>6</sup>
- The Bureau of Labor Statistics (2013) reports that, even for those workers aged 35 to 44 years, median job tenure is only 5.3 years with the current employer—demonstrating the need for portable, flexible retirement solutions.<sup>7</sup>

### Assets

- The savings and investments held in the retirement system represent the largest share of American households' total accumulated financial wealth. Americans hold \$20.8 trillion in retirement assets, outside of Social Security benefits. (as of March 2013).<sup>8</sup>
- Aggregate assets in DC plans have grown to \$5.3 trillion.<sup>9</sup>
- Aggregate assets in IRAs (includes roll-overs from other plans) have grown to \$5.7 trillion.<sup>10</sup>
- Aggregate assets for individual annuities have grown to over \$780 billion.<sup>11</sup>
- These assets invested in capital markets play an important role in the financing of real investment, which in turn is the fuel for long-run economic growth.

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1. Bureau of Labor Statistics, U.S. Department of Labor, National Compensation Survey, March 2013. (Note: Data have been rounded. In March 2013, 78% of full-time workers have access to a workplace retirement plan, and 83% of civilian workers with access participate).

2. Bureau of Labor Statistics, U.S. Department of Labor, "Employee Benefits in the United States, March 2012", USDI-12-1380, July 11, 2012 (see: <http://www.bls.gov/ncs/ebs/sp/ebrn0018.pdf>).

3. Employee Benefit Research Institute (EBRI) estimate using 2008 Panel of U.S. Census Survey of Income and Program Participation (SIPP) data.

4. Vanguard, How America Saves, 2013, Valley Forge, PA: The Vanguard Group, Inc. June 2013 (see: [https://pressroom.vanguard.com/nonindexed/2013.06.03\\_How\\_America\\_Saves\\_2013.pdf](https://pressroom.vanguard.com/nonindexed/2013.06.03_How_America_Saves_2013.pdf)).

5. Fidelity Investments, "Save Now, Play Later: Gen Y's Retirement Savings Behaviors." July 2012: 1-2

6. Vanguard, How America Saves, 2013, Valley Forge, PA: The Vanguard Group, Inc. June 2013. (see: [https://pressroom.vanguard.com/nonindexed/2013.06.03\\_How\\_America\\_Saves\\_2013.pdf](https://pressroom.vanguard.com/nonindexed/2013.06.03_How_America_Saves_2013.pdf))

7. Bureau of Labor Statistics, U.S. Department of Labor, "Employee Tenure in 2012." September 18, 2012 (see: <http://www.bls.gov/news.release/pdf/tenure.pdf>).

8. Investment Company Institute, "The U.S. Retirement Market, First Quarter 2013" June 2013 (See: [www.ici.org/info/ret\\_13\\_q1\\_data.xls](http://www.ici.org/info/ret_13_q1_data.xls)).

9. "The U.S. Retirement Market, Second Quarter 2013," September 2013, [www.ici.org/info/ret\\_13\\_q2\\_data.xls](http://www.ici.org/info/ret_13_q2_data.xls), Tables 1 and 6.

10. Ibid, Table 1. The \$20.9 trillion figure refers to assets in all kinds of retirement accounts, not just DC plans.

11. American Council of Life Insurers, Product Line Report, Annuity Insurance, February 2013 (Note: \$780 billion is based on 2011 data).

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## Life Insurers: Helping American Families Achieve a Safe and Secure Retirement

When it comes to retirement, life insurers are committed to working with policy-makers to implement solutions to expand access, increase savings, and provide guaranteed lifetime income so that every American family can achieve a comfortable, independent, and dignified retirement.

Common-sense improvements can strengthen our private retirement system and provide better retirement savings opportunities for more American households. These reforms and enhancements can, and should, be accomplished without diminishing the critical worker protections provided by ERISA, our well-established national framework for regulating private retirement plans.

### **LIFE INSURANCE COMPANIES' ROLE IN EXPANDING ACCESS**

Life insurers provide many savings options, including employer-based retirement plans for employers of all sizes, and IRAs and annuities used by millions of Americans in their retirement planning. Today, 80 percent of full-time workers have access to a workplace retirement plan. IRAs and individual annuities are available for all workers (including those without access to employer-sponsored plans) as well as to supplement workplace retirement savings. Life insurers remain committed to seeking public policy to expand coverage and access to even more workers and families.

#### **Public policy should expand access to workplace savings by:**

- Making it easier for small employers to offer workplace savings opportunities such as starter 401(k)s with simple to administer rules.

- Clarifying the rules related to multiple employer plans (MEPs) to further encourage and help employers not yet prepared to sponsor their own retirement plan to join a MEP.
- Permitting and encouraging employers currently without a workplace savings plan to automatically enroll employees into an IRA.

Employer-sponsored retirement plans offer more than 83 million American workers and their families the opportunity to accumulate savings and improve their retirement security. More than 80 percent of full-time workers with access to a plan at work participate. Life insurers endorse proven voluntary efforts to boost savings rates and continue to support public awareness about the importance of accumulating savings and generating income to last a lifetime.

#### **Public policy should encourage increased participation and savings rates by:**

- Encouraging employers to auto-enroll new employees with a default savings rate of 6 percent and remove the 10 percent cap on auto-escalation for safe harbor plans.
- Boosting savings in plans by increasing automatic escalation limits and periodic re-enrollment of noncontributing workers.
- Facilitating higher contribution levels through a "stretch match" safe harbor that encourages workers to contribute more than 6 percent of compensation without increasing employer cost.

Life insurers offer annuities, which are multi-year financial contracts that accumulate funds to provide a steady stream of income for either a set period of time or for the annuity owner's (or joint owners') lifetime.

Since annuities are the only financial product that can guarantee a lifetime income stream, they provide peace of mind and financial security for their owners.

**Public policy should facilitate access to and promote the use of guaranteed lifetime income by:**

- Promoting retirement readiness with benefit statements that show participant savings as guaranteed monthly retirement income (lifetime income disclosure) in addition to an account balance.
- Giving employers a clear way to meet their fiduciary obligation and provide guaranteed lifetime income options to plan participants.
- Easing the administrative burden on employers providing annuities in retirement plans.

**ROLE FOR THE STATES**

There is a role for states. Every business with employees regularly interacts with the state government, starting with the initial application to conduct business in the state and continuing through regular submissions of business reports and tax returns. At any of these points of interaction, the relevant state agency (U.S. Department of Treasury, Secretary of State, etc.) can provide information to employers and employees about retirement plans for workers including:

- information about types of plans;
- ways to find a retirement plan provider;

- retirement plan calculators; and
- promoting U.S. Department of Labor retirement information resources.

In addition to this employer outreach, we recommend consideration of other initiatives to increase both awareness of, and participation in, employer and individual retirement plans. These include:

- Engage public awareness campaigns with state and private resources
- Encourage participation in new federal MyRA Program
- Extend federal "savers credit" to state personal income tax, targeting lower and middle incomes
- Offer a business tax credit for new retirement plan formation
- Create financial literacy programs in the public education system
- Create public/private partnerships to directly reach employers and encourage retirement plan participation. A possible model for the states is the Michigan Department of Insurance and Financial Services (DIFS) program entitled "Reinventing MI Retirement: Achieving Financial Security to Last a Lifetime," which featured nine free DIFS events to provide Michigan residents with the best financial tools and information to plan for retirement.

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Eighty percent of full-time workers are offered enrollment in workplace retirement plans. Eighty percent participate.

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Nearly 80 percent of full time civilian workers have access...The U.S. Bureau of Labor Statistics, March 2013  
More than 80 percent participate...The U.S. Bureau of Labor Statistics, March 2013

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October 2014

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DEPARTMENT OF FINANCE BILL ANALYSIS

AMENDMENT DATE: 05/02/2012  
POSITION: Oppose

BILL NUMBER: SB 1234  
AUTHOR: De Leon, Kevin

**BILL SUMMARY: Retirement savings plans.**

This bill would create the California Secure Choice Retirement Savings Program (Program) as a retirement savings vehicle for private sector workers who do not have access to retirement plans through their jobs. The Program would be administered by a seven-member board chaired by the state Treasurer.

**FISCAL SUMMARY**

This bill would create a retirement plan for private-sector employees that is intended to be self-sustaining. However, this bill has provisions that allow for an appropriation, which would likely be from the General Fund, to support the Program.

The California Secure Choice Retirement Savings Investment Board (Board) would be required to first conduct an initial market and feasibility study to determine if the Program is self-sustaining. Funding for the study would come from a non-profit, a private entity, federal funding, or an appropriation in the annual Budget Act. A similar bill introduced in previous legislative sessions would have required the California Public Employees' Retirement System (CalPERS) to conduct such a study and manage a retirement fund for private-sector employees. CalPERS estimated the cost of producing a feasibility study would be \$1.7 million. (This bill does not require CalPERS' participation in the Program.)

If the Board determines the Program is self-sustaining, the Board then would need to, and be authorized to, receive outside funding or a budget appropriation until the asset base is built up to adequately fund administrative costs out of earnings. In previous legislation, CalPERS estimated that a similar program could cost \$1.2 million in administrative and operating costs during the initial start-up years, not including marketing and advertising. By way of comparison, the state's Scholarshare Investment Board, from which the Board in this bill is modeled, manages a college-savings program with a 9-person staff and \$2.4 million budget that is paid out of investment earnings.

Annual administrative costs also would be capped at 1 percent of assets, which may prove to be unworkable based on mandatory insurance costs. The federal Employee Retirement Income Security Act (ERISA) requires retirement-system sponsors to make annual premium payments to the Pension Benefit Guarantee Corporation (PBGC), a U.S. agency, to provide continued benefits in case the plan is closed and assets are depleted. The Program could be required to make payments to the PBGC under ERISA. The 2012 rates are \$9 per worker or retiree in multiemployer plans. The author's office estimates that 7 million people would be affected by this bill. Assuming those workers are lower earners and make 3 percent payroll contributions, the Program could have \$6.6 billion invested in the first year, according to the author's office. Based on an initial investment of \$6.6 billion in the first year, the PBGC payments would amount to \$63 million annually, or nearly 1 percent of Program assets. The bill also specifies that the Board must secure private underwriting to cover shortfalls if weak investment earnings do not provide sufficient income to provide the guaranteed interest rate to members' accounts. Life insurance companies

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Analyst/Principal (0933) K.Martone	Date	Program Budget Manager Diana Ducay	Date
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Department Deputy Director	Date
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Governor's Office:	By:	Date:	Position Approved _____
			Position Disapproved _____

De Leon, Kevin

05/02/2012

SB 1234

**FISCAL SUMMARY** (continued)

that offer guaranteed, conservative returns on annuity investments typically charge annual premiums of approximately 1 percent of assets.

Despite the bill's stated intent to shield the state from financial liability, the state ultimately could be responsible for benefit payments under federal law, putting the state at serious risk of billions of dollars in unfunded liabilities if investment performance falters under the Program. High administrative costs, particularly in initial years as the asset base is built up, puts additional pressure on the Board to achieve investment returns over and above what is guaranteed to be credited to employees' accounts, in order to cover insurance premiums and overhead. Though the stated interest rate is expected to be relatively low, the investment strategy needed will likely include a more aggressive and volatile asset mix. This, in turn, puts even more risk on the state to cover losses. The California State Teachers' Retirement System, for example, offers members a similar cash-balance program that guarantees a 3.75 percent return on members' accounts but invests the assets in the same strategy as its pension fund to achieve 7.5 percent earnings. Though the plan was fully funded as of June 30, 2011, it has recorded unfunded liabilities in 5 of its 11 years of existence, and as high as \$1.5 billion. Under the cash-balance model, employees withdraw their entire account balance upon retirement, which can quickly drain assets and put additional strain on the system. Though the author is attempting to transfer the liability to insurance companies, there is risk that an insurance company will become insolvent and will not be able to pay claims.

This bill also would require the Employment Development Department (EDD), through its investigation and audit function, to ensure that eligible employers are offering the program to employees. EDD would be required to fine eligible employers that fail to offer the program a penalty of \$1,000 per every employee unless remedied within 90 days of being notified of the violation. EDD also would be required to create an opt-out process for employees. EDD estimates \$465,000 in one-time costs for mailing and form production costs. Because the bill requires EDD to absorb enforcement costs as part of its existing investigation and audit function, EDD has not identified additional costs for this activity. This provision may generate additional workload and require additional staffing.

**COMMENTS**

Finance is opposed to this bill because it could create pressure on the General Fund to pay for start-up and administrative costs for the Program should outside funding fail to materialize. The General Fund is unable to support new programs at this time. This bill also establishes a new board at a time when the Administration is focusing on reducing the size of government.

Additionally, this bill could create a multibillion-dollar liability for the state if investment returns fail to reach cover the guaranteed rate of return and administrative overhead. All private-sector, defined-benefit plans, including cash-balance plans, operate under federal ERISA requirements, which hold plan sponsors responsible for benefit payments, among other fiduciary obligations. Governmental pension plans for public employees are exempt from ERISA and operate under state laws. Whether a state-sponsored, defined-benefit plan for private employees would fall under ERISA requirements is an open question subject to legal interpretation.

This bill would expand the state's role into private sector retirement policy, which is historically the domain of the federal government. Efforts to strengthen private sector retirement security could be pursued through Congress. Existing federal law also provides for a variety of individual retirement accounts by which employers and private citizens can save for retirement.

De Leon, Kevin

05/02/2012

SB 1234

**COMMENTS** (continued)

While a conservative-growth retirement fund may be appealing to some employees, the compulsory nature of the Program and low guaranteed yields would limit investment choices for employees who may have a higher threshold for risk and desire a more aggressive investment strategy. Because the Program is required for businesses that do not offer retirement savings plan to employees, there is nothing to prevent a business that currently offers its employees a more generous retirement plan from dropping it in favor of the state-sponsored plan. Additional burdens would be placed on businesses to administer the payroll deduction.

Specifically this bill:

- Establishes the California Secure Choice Retirement Savings Trust for the stated purpose of promoting greater retirement savings for California private employees in a convenient, voluntary, low cost, and portable manner.
- Creates a seven-member California Secure Choice Retirement Savings Investment Board to administer the trust. The Board would be composed of the Treasurer (chair), Director of Finance, Controller, an individual with retirement savings and investment expertise appointed by the Senate Rules Committee, a small business representative and a public member each appointed by the Governor, and an employee representative appointed by the Assembly Speaker. The Board would hire investment managers to oversee assets in the trust. CalPERS would be authorized, but not required, to bid on an investment management contract to invest the Program's assets.
- Requires any private business with five or more employees and that do not offer an employer-sponsored retirement plan, to establish a payroll deposit retirement savings arrangement to the Program.
- Provides that employers with more than 100 employees would be required to make the plan available to employees within 3 months after the Board opens the Program for enrollment. Employers with more than 50 employees would have 6 months, and employers with more than 5 employees would have 9 months to establish the payroll deduction.
- Creates nominal accounts for employees to make contributions. Employees would not manage their individual accounts; the accounts would be pooled, managed professionally, and credited at a stated interest rate, adjusted annually by the Board, and compounded daily. The stated interest rate would likely be tied to a 30-year U.S. Treasury bond rate. Employees would receive the balance of the account upon retirement.
- Mandates participation for employees unless they opt out of the Program through an EDD exemption form. The employee would be required to elect to opt out every 24 months or the employee would be automatically re-enrolled.
- Sets the default contribution rate for employees at 3 percent of salary or wages. The Board may adjust the contribution amount between 2 to 4 percent. Employer contributions would be optional.
- Stipulates that all costs of administration of the trust shall be paid out of the administrative fund, from earnings on deposits. The provisions of the bill become operative only if funds are made available through a nonprofit, private entity, or federal funding, or a state appropriation, in amounts sufficient to allow the Board to study, develop, and obtain the approvals necessary to implement the Program.
- Limits expenditures from the administrative fund to one percent of the total Program fund.

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SB 1234

**COMMENTS** (continued)

- Directs the Board to conduct a market analysis to determine the feasibility of the Program. Requires the Board to determine, through the study, if the Program is self-sustaining and report the finding to various legislative committees and the Director of Finance.
- Provides that the state "shall have no liability for the payment of the benefit" and requires the Board to secure insurance against investment losses.
- Creates a reserve account from excess earnings that can be used to credit accounts if the stated interest rate cannot be met from investment earning or to credit accounts with additional earnings when there is an actuarial surplus.
- Authorizes EDD, beginning January 1, 2014, to fine employers who fail to make the program available. The fine would be \$1,000 per employee following a 90-day warning period.
- Requires the Board to issue an annual audited financial report to the Governor, Controller, State Auditor, and Legislature.

Code/Department Agency or Revenue Type	SO	(Fiscal Impact by Fiscal Year)					Fund Code	
	LA	(Dollars in Thousands)						
	CO	PROP						
	RV	98	FC	2011-2012	FC	2012-2013	FC	2013-2014
0950/St Treasurer	SO	No		----	See Fiscal Summary	----		0001
1900/PERS	SO	No		----	See Fiscal Summary	----		0001
7100/EDD	SO	No	A	--	C	465	A	-- 0001

# **VOLUNTARY EMPLOYEE ACCOUNTS PROGRAM STUDY**

## **SUMMARY**

Page 63 of the 2007 Joint Chairmen's Report requests the Maryland Supplemental Retirement Plans (MSRP) to conduct a study of the feasibility of the State sponsoring a voluntary employee accounts program (VEAP) for private sector employers and employees. That request is an outgrowth of H.B. 823, which was introduced during the 2007 General Assembly Session. The study directs MSRP to examine several factors relating to this program, including cost efficiencies, potential for State liability, and organization and administration requirements.

The perception that prompts the study—that small businesses with few employees find it difficult or expensive to establish retirement saving plans—is generally borne out by numerous studies that track overall workforce participation in private pensions plans. A system of State-sponsored and administered employee retirement accounts is a potentially worthwhile idea, but would be difficult to implement in the current environment.

A number of long-term administrative efficiencies could be created by the program. There are no short-term efficiencies, however, chiefly because the program involves collecting small amounts of data and dollars from a large number of sources. MSRP estimates that it will take several years before the program becomes self-sufficient; in the interim it will require a subsidy of between \$300,000 and \$500,000 a year for at least 5 to 7 years.

It is not legally possible to eliminate the risk of State liability which could occur because of administrative and fiduciary mistakes. However, the risk could be reduced through prudent practices and certain elements of program design. As stated above, it

will require significant State expenditures to design and maintain a quality program. A failure to expend funds under the theory that interested private financial entities can “take care of everything” would only serve to substantially increase the risk of liability to the State.

Under current law the program would also require a number of innovative rulings from federal agencies. These rulings would be designed to allow the State a limited but defined role in pension administration for practice areas normally governed by employer decision. The State would, in effect, become a joint (but limited) plan sponsor and administrator of the separate saving plans that adopted the program.

Prospects for an assistance program of this type would be enormously enhanced by changes in federal law. For example, one proposal pending in Congress would require most employers to offer some type of payroll deduction retirement I.R.A. or other retirement savings account. In similar terms, amendments to federal pension law could specifically authorize a State to sponsor this type of program. This type of legal authority, similar to what now exists for Section 529 college saving plans, would greatly increase program potential, because it would increase employer confidence in a State sponsored arrangement. It is possible to create a program without these changes to federal law, but employers may decline to participate because of its uncertain status.

# Administrative Costs of State Run Defined Benefit Plans

Commissioned by American Council of Life Insurers



Richard Wright, FSA, MAAA

In response to studies showing inadequate retirement savings by workers, some states are considering legislation that would require private employers who don't already offer a retirement plan to automatically enroll employees into a retirement program. In evaluating the merits of these proposals, it is important to consider the administrative requirements and costs of these efforts.

## QUALIFICATION REQUIREMENTS

The Employee Retirement and Insurance Security Act of 1974 (ERISA) and the Internal Revenue Code (IRC) contain requirements that apply to retirement plan arrangements of private employers. ERISA requirements apply to all plans. IRC requirements must be met in order for the program to be "qualified," which allows investment earnings and employer contributions to be tax-deferred. These laws and regulations try to ensure retirement programs are adequately funded and attempt to prevent abuses such as shady investments or employers only providing benefits to the most highly compensated employees.

Retirement programs fall into two main categories: Defined Benefit (DB) plans and Defined Contribution (DC) plans. DB plans typically provide a monthly benefit at retirement, usually based upon the compensation and years of service of the employee. DC plans typically provide a lump sum benefit equal to the accumulated value of contributions made on behalf of the employee.

Plan qualification requirements differ between DB and DC plans. For example, defined benefit plans must pay annual premiums to the Pension Benefit Guaranty Corporation (PBGC), a federal government agency that guarantees benefits provided by defined benefit plans. Defined benefit plans are also required to have an actuarial valuation done each year to determine the appropriate funding amount.

Defined contribution plans are not covered by the PBGC, do not need to pay premiums to the PBGC, and do not require actuarial valuations.

## ADMINISTRATION

Administrative requirements that apply to retirement plans sponsored by private employers include the following:

- Plan document drafting
- Summary Plan Descriptions
- Periodic amendments to maintain compliance with federal laws and regulations
- Annual auditor report (if 100+ eligible)
- Periodic benefit statements
- Record-keeping
- Investment oversight
- Trust accounting
- Nondiscrimination testing
- Benefit processing

In addition, the following items apply to defined benefit retirement plans sponsored by private employers:

- Annual actuarial valuation
- Annual PBGC premium filing
- Annual funding notices

A retirement program with multiple employers may be able to reduce the administrative burden by qualifying as a multiple employer plan. However, a recent ruling from the Department of Labor (DOL 2012-04A) states that a multiple employer plan that consists of unrelated employers "does not constitute a single multiple employer plan for purposes of ERISA, but rather an arrangement under which each participating employer establishes and maintains a separate employee benefit plan for the benefit of its own employees."

This distinction is important. If a state run retirement program is a collection of single employer plans, annual government filings will be required for each participating employer. In addition, if the state run retirement program is a defined benefit plan, the funding of the program will require individual actuarial valuations for each private employer (*IRC Section 413(c)(4)(A)*).

**EMPLOYERS WITHOUT RETIREMENT PLANS**

The number of private employers that would be subject to a mandatory state run retirement program could be quite large. This is because small employers are much less likely to offer a retirement plan than large employers (Figure 1). And there are a lot more small employers than large employers (Figure 2).

**Figure 1**  
**Percentage of Workers Whose Employer Does Not Sponsor Retirement Plan**

Size of Employer (# of employees)	% Without Retirement Plan
Less than 10	82.4%
10-49	67.5%
50-99	54.9%
100-499	43.3%
500-999	40.0%
1000 +	31.1%

*Source: Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2010 by Craig Copeland, Employee Benefit Research Institute*

**Figure 2**  
**California Businesses With at Least 5 Employees**

Number of Employees	California Businesses
5-10	150,566
10-49	182,613
50-99	29,706
100-499	19,204
500-999	1,444
1000 +	865
<b>Total</b>	<b>384,398</b>

*Source: California Employment Development Department, Labor Market Information Division for Third Quarter, 2010*

Combining the results in Figure 1 and 2 produces an estimate of 272, 801 employers in California that do not offer a retirement plan (Figure 3).

**Figure 3**  
**Estimated Number of California Businesses Without a Retirement Plan**

Number of Employees	CA Businesses w/o Retirement Plan
5-10	124,066
10-49	123,264
50-99	16,309
100-499	8,315
500-999	578
1000 +	269
<b>Total</b>	<b>272,801</b>

**ESTIMATED ADMINISTRATIVE COSTS**

Administrative costs for retirement plans generally fall into two categories: fixed costs that apply regardless of plan size and variable costs based upon the number of plan participants. Fixed costs include such things as the drafting of a plan document detailing the terms and conditions of the plan, and annual government filings. Variable costs include such things as record-keeping and the payment of PBGC premiums for defined benefit plans.

Administrative costs vary greatly among retirement plans depending upon whether it is a DB or DC design, the complexity of the plan, and the extent of any customization. A state run plan could be designed to minimize complexity and could require that the same plan provisions apply to all employers. Still, it is unlikely that the fixed costs for a state run DB plan could be less than \$500 per employer per year, plus an additional amount based upon the number of participants.

The administrative costs for CalPERS, which covers about 1.6 million state and local government members is about \$350 million per year, or \$218 per member. The administrative costs for CalSTRS, which covers about 850,000 teachers is about \$110 million per year, or \$129 per member. CalPERS and CalSTRS are both governmental plans exempt from PBGC premiums and many of the requirements of ERISA and the IRC.

Based upon the above, a low estimate of the per participant administrative cost for a state run DB plan for private employers is \$100 per participant, plus PBGC premiums. However, the administrative costs could easily exceed this amount since DB plans for private employers are subject to additional ERISA and IRC requirements that don't apply to governmental employers.

PBGC premiums for DB plans are currently \$35 per participant per year, plus an additional amount for underfunded plans. The premium is scheduled to increase to \$49 per participant in 2014.

Using these assumptions, the estimated administrative costs for a state run DB plan consisting of 200,000 employers and 5,000,000 participants could be \$775,000,000 or more (Figure 4).

**Figure 4**  
**Estimated Annual Administrative Costs**  
**of State Run DB Retirement Plan**

Fixed cost per employer	\$500
Employers	<u>x 200,000</u>
Fixed costs	\$100,000,000
Administrative and PBGC costs	\$135
Participants	<u>x 5,000,000</u>
Variable costs	\$675,000,000
Estimated annual administrative costs	\$775,000,000

*Assumptions:*

- (1) Multiple employer defined benefit plan subject to individual employer funding calculations pursuant to IRC 413(c)(4)(A)
- (2) Fixed costs of \$500/yr per employer
- (3) Administrative costs of \$100/yr per participant
- (4) PBGC premiums of \$35/yr per participant

**IN SUMMARY**

While a state run defined benefit plan for private employers may help increase the retirement income for workers of private employers, the administrative costs of a defined benefit program will be substantial, due to the laws and regulations that apply to retirement plans of private employers.

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