



Connecticut Retirement Security Board  
RFI Response  
November 2014

Responses are not required nor expected to include answers to all of the questions below.

## Plan Design

1. *What plan structure would you recommend in order to meet the statutory goals and design features (listed above)?*

### The Online 401(k) Solution

#### Safe Harbor Status provided by the IRA Structure

DOL Interpretive Bulletin 99-1<sup>1</sup> defines the terms under which employers must operate Payroll Deduction IRAs in order to avoid operating a Pension Plan, and thus be granted Safe Harbor from ERISA. The current IRA structure is necessary for that purpose.

#### Portability

The Employee Account must be portable to any other IRA. However, the Employee should have no requirement to move it upon termination of employment, or, if the Employee changes jobs to another participating Employer, the Employee can simply change the funding source to the new Employer to continue the benefits of payroll deduction.

#### Web Delivery Backstopped with Paper

- ▶ Employers should be encouraged—perhaps defaulted—to deliver census and payroll info online, and to make deposits via ACH. Dissemination of information to Employees (enrollment, account information, statements) should be delivered via the Web and electronic communications such as e-mail, mobile application pushes, and text.
- ▶ Paper processes (i.e., enrollment via fax, statements, deposits via checks) could be provided and distributed via the EDD.

#### Omnibus IRA

Our experience with existing Payroll Deduction IRA products leads us to recommend an Omnibus IRA approach: one account of pooled Employee assets, for the purpose of recordkeeping, not investment management, with recordkeeping technology tracking individual Employee accounts, balances, and records. Employees will still have the ability to self-direct their investments from the list of approved/recommended investments by the Board and/or its vendors.

#### Investments

We recognize the benefits of preservation of principal and believe a cash account should be available. However, we also believe that the “one size fits all, guaranteed interest” investment approach is needlessly broad and restrictive. Technology now allows easy implementation of customized investment strategies, suited to individual circumstance, which allow Participants to take risk suited to their personal situation. Professional and independent third parties offer managed, low-cost, indexed portfolios tailored to individual Participant’s time-horizon and risk (for example, there is no need to default or force a 25-year-old Employee into a guaranteed rate of return). This allows those with short time frames and low tolerance to avoid risk, while allowing those with long time frames and an appetite for risk to assume it, along with the returns that follow.

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<sup>1</sup> US Department of Labor Interpretive bulletin; Payroll Deduction Programs for Individual Retirement Accounts (06.18.1999)

We propose that Participants be opted-in to a default account of “cash” until the lapse of the 90-day withdrawal period, at which point they would be phased-in to a model portfolio of low-cost, passively managed ETFs according to age.

We suggest the decumulation stage be annuitized, but not necessarily by an annuity. Annuities carry costs, and are only as good as the creditworthiness of the insurer, which ultimately invites liability on the State.

2. *How would you recommend satisfying the requirement that the plan maintain an annually predetermined guaranteed rate of return? Would you recommend obtaining private insurance?*

3. *What amount would you recommend as the default contribution rate? Why?*

We would recommend a default 3%, as national data seems to support this level is barely noticeable to an Employee. Therefore, opt-outs would be minimal.

4. *Would you recommend the plan automatically increase Participants' contributions over time? If so, by how much, and at what time?*

We would suggest annual 1% increases to 15% so that Participant's savings keeps up with inflation and/or increases in wages, as well as maximizing any existing Employer-based match.

5. *Would you recommend immediate vesting of the Participant's contributions? What about the Employer's contributions?*

Employees are immediately vested in their own contributions.

Our prototype plan offers the following choices:

- ▶ 100% upon entering Plan
  - ▶ **2 year cliff vesting** — An employee is 0% vested for two years. Once an employee has attained 2 years of service they are 100% vested.
  - ▶ **3 year cliff vesting** — An employee is 0% vested for three years. Once an employee has attained 3 years of service they are 100% vested.
  - ▶ **25% over 4 years** — Each year that an employee attains a year of service they are credited with 25% vesting.
  - ▶ **20% over 5 years** — Each year that an employee attains a year of service they are credited with 20% vesting.
  - ▶ **20% over 6 years** — An employee is 0% vested after the first year, then each year that an employee attains a year of service they are credited with 20% vesting.
6. *How would you recommend minimizing the funds that Participants withdraw from their retirement accounts prior to their retirement in order to minimize fees assessed on the funds (or pre-retirement “leakage”)?*

To minimize “leakage,” CRSB should have IRA Rules: no loans and no hardships.

CRSB should offer portability to alternate IRAs upon termination of employment, as well as a simple change of the funding source (i.e., maintain with the Employer or continue themselves with a direct debit from their bank account in lieu of payroll deduction) when Participants leave one Employer participating in the CRSB for another Employer participating in the CRSB.

The Online 401(k) already has a market solution for this scenario: Saver(k). Saver(k) is an IRA for which payroll deductions have been replaced by bank account debits. Saver(k) offers the same platform, investments, and experience as an Employer-facilitated IRA, the only difference is the source of the savings.

If the goal is to increase retirement savings, then we believe that once someone is in a plan and saving, we need to make it as easy as possible to support that good habit.

**7. Do you have any additional concerns about the plan design features? If so, how could those concerns be addressed?**

No concerns at this time.

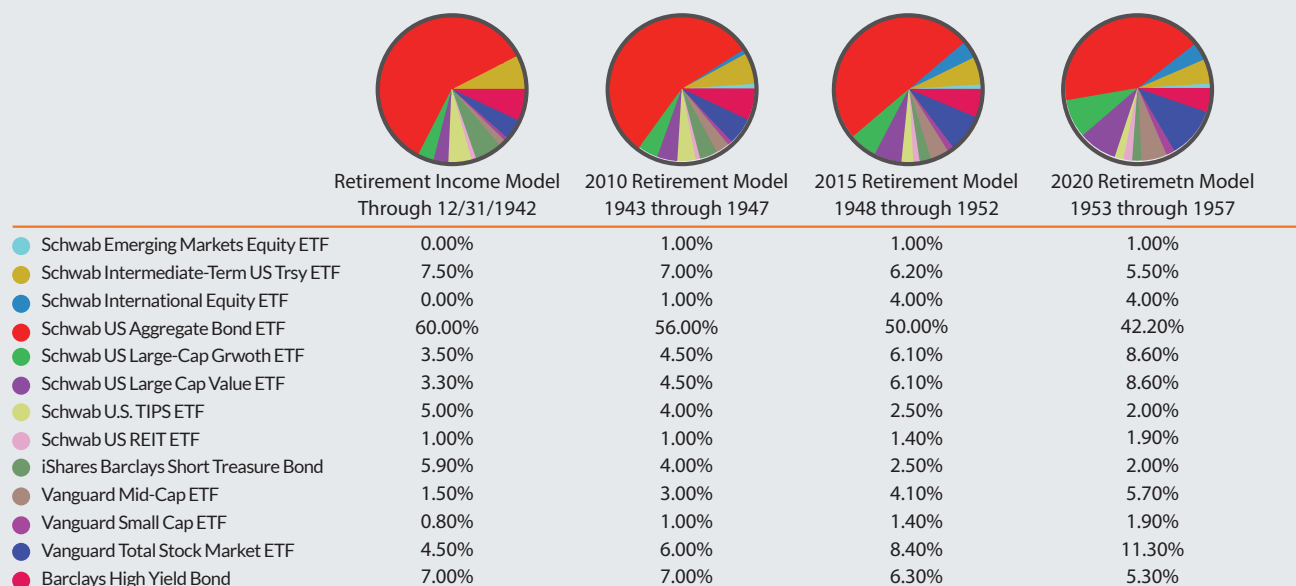
## Investments

**8. What investments would you recommend to satisfy the statutory goals of the plan, including the types of funds and underlying assets? What style of management (active vs. passive) would you recommend?**

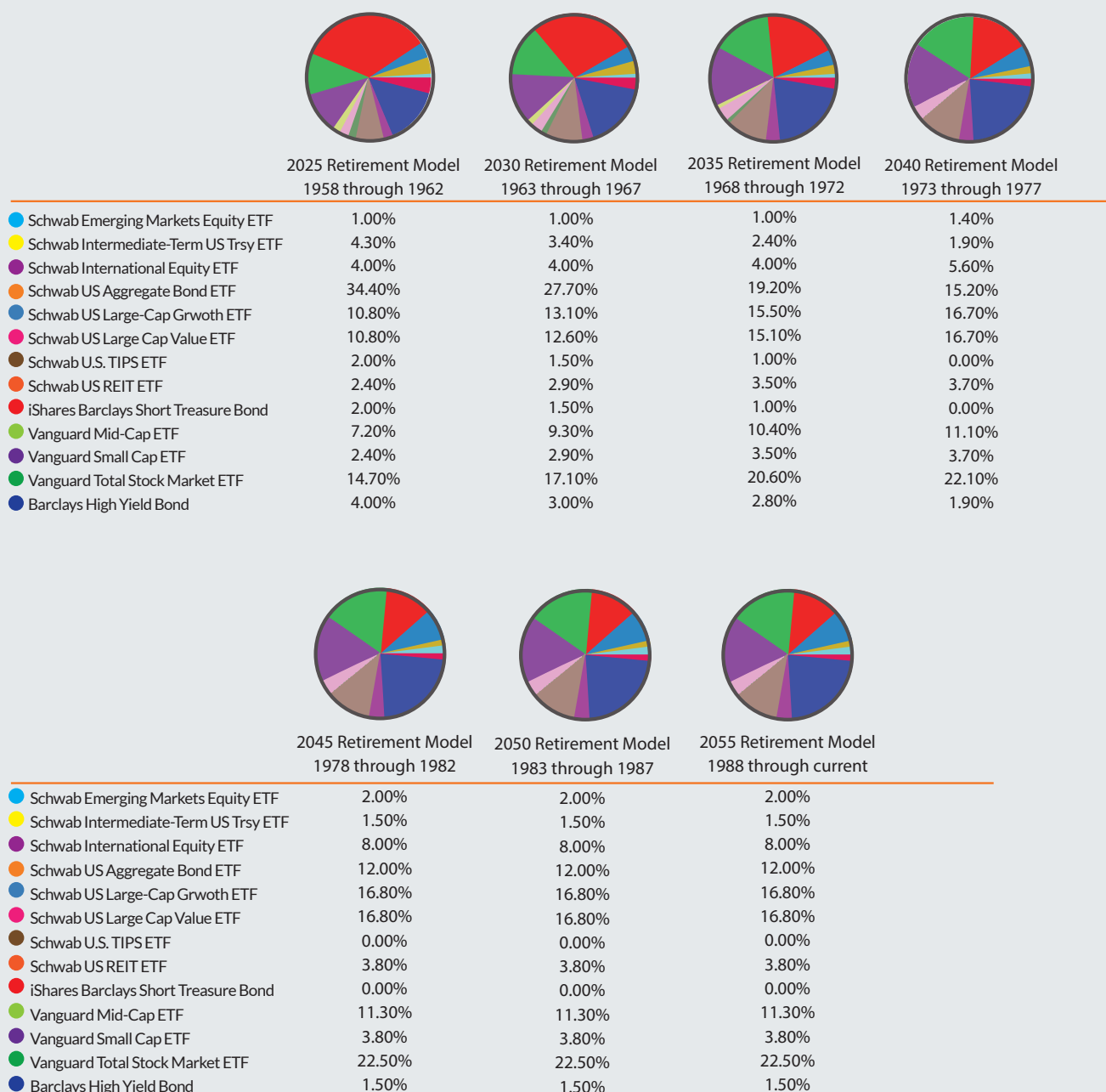
First and foremost, it should be noted that The Online 401(k) is investment agnostic. TOK does not sell, advise on, or broker investment solutions. However, we have extensive experience that allows us to have an informed opinion on the subject of investments, and investments in retirement savings plans.

Based upon our more than 15 years experience selling Workplace Savings Plans, we suggest professionally managed Target Date Portfolios of Exchange Traded Funds. Passive management minimizes style drift, lowers investment expense, and limits transaction costs and is, therefore, the recommended style of management. Cost control leads to a better return on investment for the saver. For similar reasons, we recommend ETFs: they are low-cost, enable “ownership of the market,” and deliver perfect visibility into the underlying assets owned.

### THE ONLINE 401(k) ALLOCATION MODELS



## THE ONLINE 401(k) ALLOCATION MODELS



Investment cost is extremely important. The time value of money, aka “compounding effect”, where even a 1% difference in net fees exists, can add up to literally hundreds of thousands of dollars in fees over a saver’s lifetime.

## Cumulative Results of 401(k) Fees After 30 Years

### ENDING BALANCE



The Online 401(k)  
\$445,756  
@0.25% FEES



Option B  
\$384,489  
@0.96% FEES



Option C  
\$273,081  
@2.50% FEES

*Assumptions* // Save \$300 a month // Net return is gross return minus fees // Gross return is 5% – compounded monthly // Beginning balance – \$50,000

We would suggest, and currently provide to our clients, up to 10 professionally managed portfolios. Employees complete a simple Risk Tolerance Questionnaire and are automatically enrolled in the appropriate portfolio. The all-inclusive asset fee for these portfolios averages only 25 basis points, or 0.25%. Compare that to a well known, nationally recognized insurance company who is offering investments in their workplace savings plans for 250 basis points, or 2.5% — ten times the cost.

For those determined to avoid all Market Risk, Preservation of Principal should be offered via a Cash Option, such as Treasuries, or FDIC-insured product. Employee balances could be annuitized (though not without an annuity) as Employees enter Retirement.

### 9. *Would you recommend more than one investment option? If so, what would you recommend as the default option?*

We would recommend a Conservative Portfolio as the default; after the 90-day withdrawal period, unless the Employee has indicated otherwise, it will be phased into the market and into a model according to their age. We suggest “Target Date Model Portfolios” rather than “Target Date Mutual Funds” for a few reasons:

Target Date Funds are managed to time horizon, rather than a time horizon and risk tolerance.

Target Date Funds lack a common standard of measure, making benchmarking difficult.

Target Date Funds have opaque pricing which has faced criticism of the fund-of-funds target date industry.

Our Target Date Model Portfolios of ETFs do not carry these issues. Because these are portfolios, not actual funds, the management of them is in the best interest of the Employee.

### 10. *Would you recommend an annuitized benefit, a lump sum payout, a lifelong stream of income, or multiple options? How would you structure each option? Would your recommendations require changes to the statutory investment policy parameters? What amendments to the statute would you recommend?*

## **11. What recommendations would you make to ensure an effective risk management system is in place?**

Benchmarking will be key. This is something the retirement industry is currently struggling with, as it has been purposefully hard to do apples-to-apples comparisons. In light of 408(b)(2) and 404(a)(5), 'Fee Disclosure' regulations recently enacted by the Department of Labor, and with forthcoming potential enhancements and refinement of these regulations, the industry may finally have a definitive source for real information that others in the industry will tabulate for proper benchmarking. The free market, under these enhancements, will then stand a chance at self-regulating the industry into reasonableness.

Benchmarking however, right now will primarily focus on fees in retirement plans. Risk management, which is a very subjective term, could follow similar methods, if standards are defined, and public reporting is required. We interpret "Risk Management" in this context to mean managing the risk of the investments being offered and/or managed on behalf of the Employees. It is our preference, as noted above, that these accounts are self-directed with assistance (through Model Portfolios), rather than an approach where there is a pool of money being managed for the masses. It is our understanding that the objective of the Board is to minimize the involvement of, risk to, and liability of The State of Connecticut. And, by making the accounts self-directed, and by establishing initial and ongoing criteria that providers to the program must adhere to, risk management would be addressed through this method.

## **Administrative Issues**

### **12. How would you recommend qualified Employers structure the payroll deduction process to credit the plan Participant's contributions to his or her individual retirement account through payroll deposit?**

ACH?

### **13. How would you recommend managing the enrollment, receipt, and recordkeeping of employee payroll contributions and transactions?**

- ▶ The employer, through a dedicated plan management website, provides their Employee census information to The Online 401(k) that includes Employee e-mail and other contact information.
- ▶ Employees are sent a welcome e-mail inviting them to an Online Enrollment Meeting, and to let them know they are eligible for this new work place retirement savings plan, and that they will be auto-enrolled and invested unless they take action to opt-out.
- ▶ Employees are auto-enrolled at 3%. Employers upload payroll deferrals every pay period. Deposits are made via ACH, and invested according to Employee elections /defaults.
- ▶ Employees make changes in deferral amounts online (employers notified of changes in deferral amount via email, with a printable document for Employees to submit to the Employers.)

Employees make changes to their investments via website/mobile applications.

### **14. How would you recommend managing rollovers and closures of plan accounts?**

Rollovers and disbursements are handled the same way as above.

### **15. How would you recommend identifying eligible employers and disseminating information to eligible employers and their employees?**

Based on our experience in this space for more than 14 years, we recommend that the default Employer Communication be via Web, electronic communications such as e-mail, mobile application pushes, and text.

In all our experience, there were less than a handful of times when workarounds such as a shared terminal in the workplace, or the Employer willing to take on some of the leg-work did not work out. Electronic communication is much more prevalent than many are lead to believe, and the notion that all must adhere to the paper-based world to accommodate a few is what causes costs to be higher than necessary, thus reducing Employees retirement savings. If paper materials are requested, it has been suggested that the Employer may receive communications disseminated via the EDD.

Alternatively, if the EDD and the State of Connecticut prefer not to have that level of involvement, The Online 401(k), through various partnerships and fulfillment partners, can create a paper-based version of the solution discussed. This would incur higher costs, and those costs would be passed onto the Employers and Employees of the plans where this option was chosen. The incentive clearly lies in the utilization of low-cost electronic communications, but it is not dependent on that exclusively.

**16. Do you have any additional concerns about the administration of this plan? If so, how could those concerns be addressed?**

No concerns at this time.

## Legal Issues

**17. How would you recommend obtaining a favorable ruling from the Department of Labor that the plan is either exempt from ERISA coverage under an exception or that ERISA does not cover the plan?**

DOL Interpretive Bulletin 99-1 defines the terms under which Employers must operate Payroll Deduction IRAs to avoid operating a "Pension Plan," and thus be granted Safe Harbor from ERISA.

These include:

- ▶ No Employer Contributions
- ▶ Employee Participation is strictly voluntary
- ▶ Employer's activities with respect to the IRA must be limited solely to permitting, without endorsement, the IRA sponsor to publicize its programs to employees, collecting contributions through payroll deductions or dues check-offs; and remitting those contributions to the IRA Sponsor.
- ▶ Employer may receive no consideration in any form, other than reasonable compensation for services actually rendered in connection with the payroll deduction or dues check-off systems. Each of these requirements is further clarified by the Bulletin. With adherence, the Program will not be subject to ERISA, and account holders will enjoy tax-privileged status.

**18. How would you recommend obtaining a ruling from the IRS that the plan qualifies for favorable income tax treatment as individual retirement accounts?**

**19. What recommendations, if any, would you have toward amending or enacting statutes and/or regulations in order to improve the legal requirements of the plan? Would you recommend any amendments to the enacting legislation of the CRSB (P.A. 14-217)?**

The DOL has already provided the Safe Harbor, as above.

**20. Do you have any additional legal concerns surrounding this plan? If so, how could those concerns be addressed?**

## Costs and Fees

### 21. How would you recommend minimizing ongoing administrative costs and fees associated with the plan?

To paint a picture of what's possible, "Starter(k)" — The Online 401(k)'s existing Payroll Deduction IRA utilizes professionally managed portfolios of ETFs (such as those offered by Vanguard, Schwab, and iShares) covering the risk and time-horizon spectrum.

These costs are as follows:

ETFs:	.09%
3rd Party Fiduciary Management:	.10%
Transaction & Custodial Costs:	.06%
<b>Total Asset Charges:</b>	<b>.25%</b>

The Online 401(k) is already delivering a low-cost Payroll Deduction IRA.

### 22. How would you recommend calculating the estimated startup costs of the plan? What would you estimate those costs to be? How would you recommend covering those startup costs?

From The Online 401(k)'s perspective, the product and its infrastructure already exist, i.e., the Starter(k) platform. Therefore, the start-up costs are negligible as the solution is currently live in the market.

### 23. How would you recommend minimizing any administrative costs to the Employers?

We have developed several pricing models that carry zero- and low-cost to employers.

In terms of pricing, the following is possible:

Cost to Employer:	\$0
Cost to Employee:	\$3 per month
Investment & Plan Cost:	not to exceed 1% annually of assets

The three variables could all go up or down, so for example, it could be:

Cost to Employer:	\$10 per month
Cost to Employee:	\$2 per month
Investment & Plan Cost:	not to exceed 1% annually of assets

Or

Cost to Employer:	\$15 per month
Cost to Employee:	\$2 per month
Investment & Plan Cost:	not to exceed 0.75% annually of assets

### 24. How would you recommend achieving transparency and accountability in the management of the retirement funds?

We suggest three service providers: a Record-keeper with fixed costs, a custodian, and a Third-Party Fiduciary Manager. In order to increase transparency, The Online 401(k) suggests the use of ETFs (or other Institutional-Class Mutual Funds) that are void of "Revenue Sharing."

When one provider is all three, there is inherent conflict of interest and too many ways to hide fees. One's objectivity is compromised, and it is the Employee who ultimately pays that price.

**25. Do you have any additional concerns regarding the costs of this plan?**

We have no concerns to raise at this time.

## Retirement Plan Vendors Website

**26. What level of interest would vendors have in establishing a secure Website to assist qualified Employers in identifying vendors of retirement plans that may be implemented by qualified Employers in lieu of participation in the plan? How should the Board determine that interest?**

**27. How would you recommend establishing a process for vetting vendors to include on the Website?**

Vendors should have Small Business Retirement/IRA domain expertise. Working in this space requires an emphasis on design and ease-of-use best delivered via the Web.

As for qualifications, we do not believe it necessary that providers be a regulated entity (i.e., FINRA or SEC), since investing is only one part of the solution and, as in our case, is outsourced to parties that are SEC registered.

**28. What information is most important for Employers to know about vendors on the Website?**

A clear understanding of the vendor's Revenue Model — whether fixed per number of account holders or predicated upon assets/investments/insurance.

**29. How would you recommend operating the Website effectively and efficiently, in a manner that minimizes liability?**

For effectiveness and efficiency, we recommend implementing a cloud-based Web solution. Cloud solutions allow tremendous flexibility in scaling performance and storage for current and future demand. They also support high availability options for multiple electrical grids, hosting in diverse geographical regions, multiple carrier connectivity, and third-party vendor support options. Cloud solutions also support high security solutions that meet the most stringent industry standards including Payment Card Industry (PCI), Health Insurance Portability and Accountability Act (HIPAA), Health Information Technology for Economic and Clinical Health (HITECH) Act, ISO 27001, FedRAMP, DoD Cloud Security Model, etc.

To maximize site security and protection of client data, we recommend enabling strong encryption options and standards (e.g., HTTPS with TLSv1.2 and AES-128) for data in motion and at rest (i.e., encrypt data in transmission, encrypt data on disk or any storage). We recommend mandatory use of multi-factor authentication for administrative and privileged users. We recommend providing client/consumers with an option for multi-factor authentication including strong passwords, a smartphone security app, and/or SMS text.

It is important to have clearly assigned responsibilities and ideally some service level agreement for availability including maximum Recovery Time Objectives (RTO — the time at which operations will have resumed, i.e., how long it will take to be running again) and Recovery Point Objectives (RPO — the point in time in the past to which you will recover i.e., how much data can be lost) for worse case Disaster Recovery and Business Continuity. Require the Website operator provide clear policies, procedures, and training to all operational personnel including a 24x7x365 incident response process, escalation and alert process, and vulnerability management process.

Employ qualified third parties to continuously monitor and scan the Website for vulnerabilities, require periodic qualified third-party audits of Website operations to any required standards, require bi-annual testing of DR/BC recovery scenarios to verify RTO, RPO, procedural, and operator skills requirements, and finally require a minimum level of insurance coverage.

30. *Do you have any additional concerns on creating a secure Website for vendors of retirement plans for the use of eligible Employers?*

If the above criteria are met, then no additional concerns.

## Funding

31. *How would you recommend seeking funding for the market feasibility study?*

We do not have any recommendations at this time.

32. *Would you suggest any particular types of organizations that may be willing to donate significant funding for the study?*

Heritage, Brookings, EBRI, ASPPA, AARP

33. *Given that some organizations do not or cannot donate directly to governments, will that make it more difficult to raise money? If so, can you suggest funding solutions or arrangements that might help to avoid this difficulty while maintaining the state's independent oversight and jurisdiction over the study?*

We have no opinion on this question.

34. *Do you have any additional concerns about funding the market feasibility study?*

## Additional Information

35. *Do you have any additional concerns about the CRSB conducting the market feasibility study?*

36. *Do you have any additional concerns about any aspects of the operations of the CRSB?*

37. *What is your personal story? How would this program benefit you? Or harm you? Why?*