



## STATE OF CONNECTICUT

# RETIREMENT SECURITY BOARD

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

Connecticut Retirement Security Board  
Meeting Minutes  
Friday, October 16, 2015  
9:00 A.M.  
Legislative Office Building, Hartford, Room 1B

### Members Present:

Hon. Kevin Lembo, State Comptroller, Co-Chair  
Hon. Denise Nappier, State Treasurer, Co-Chair  
Deputy Commissioner Dennis Murphy (on behalf of Commissioner Sharon Palmer)  
Michael Callahan (via phone)  
Ken Floryan  
George Kasper  
Sal Luciano  
Jamie Mills  
James Russell (via phone)  
John Sayour

### Members Absent:

Thomas Barnes  
William Kosturko  
Brendan Maher

### Special Guests:

Ernest Lorimer, Finn Dixon & Herling  
Jose Singer-Freeman, Finn Dixon & Herling  
David Levine, Groom Law Group  
Arun Muralidhar, George Washington University  
David C. John, AARP Public Policy Institute  
Kathleen Kennedy Townsend, Former Lt. Governor of Maryland  
Andrea Feirstein, AKF Consulting Group

### A. Call to Order

Comptroller Lembo called the meeting to order at 9:06 a.m.



## **B. Introduction of Law Firms**

Comptroller Lembo introduced Ernest Lorimer and Jose Singer-Freeman from Finn Dixon & Herling and David Levine from Groom Law Group, who are the attorneys retained by the Board. Comptroller Lembo explained that the law firms will be meeting with the contractors next week to bring them fully up to speed. The Board will hear from them at the next Board meeting.

Mr. Lorimer explained that his law firm is looking forward to helping the Board come to a conclusion on its feasibility study. Finn Dixon & Herling will be focusing on the state law aspects of structuring this program. Mr. Levine explained he is looking forward to helping the Board with its process as well. Groom Law Group will be focusing on the federal law, regulations, and the national progress of these initiatives in D.C.

Comptroller Lembo explained that there will not be public comment or a financial report update because of the long agenda today; however, they will return at the next Board meeting.

## **C. Presentations**

Comptroller Lembo thanked the presenters for taking the time to present before the Board. He indicated that each presenter had thirty minutes, so approximately 15 – 20 minutes for speaking and 10 – 15 minutes for questions from the Board.

Comptroller Lembo introduced Dr. Arun Muralidhar, who is an Adjunct Professor of Finance at George Washington University, Founder of Mcube Investment Technologies, co-author of “Rethinking Pension Reform” on reforming Social Security, former manager of the World Bank’s Pension Fund, and who has a PhD from MIT Sloan School of Management. Dr. Muralidhar explained that he mainly focuses on investments. He became involved in the state retirement efforts by Kathleen Kennedy Townsend’s encouragement. Dr. Muralidhar serves as an advisor to Overture Financial, which is the consultant for California’s Secure Choice Board. He explained that the failure of earlier retirement savings reform efforts was a result of the failure to follow an adequate process. The appropriate process is to separate out the goals from the design features. An off the shelf retirement plan will not fit all the provisions of the Board’s statute, so the Board needs to be innovative. The Board needs to first survey the target population. This population is likely low-income, so even a 1% fee will have a drastic impact on their retirement savings, so the Board should focus on a low cost program. Obtaining a low cost, liquid annuity is not really feasible, but this population will really emphasize the need for liquidity. Auto-enrollment may be an issue because some of this population is likely to be highly indebted. Forcing these people to participate will increase their indebtedness. He believes the idea of a guaranteed rate of return works well for Social Security because it is backed by the government. Since the Board’s statute precludes liability on the State, such a guarantee in a defined contribution plan will be costly. The Board should focus on a guaranteed annuity rather than guaranteed wealth.

Although the Department of Labor has given safe harbor protection to target date funds, Dr. Muralidhar believes they are a terrible investment. He explains that a target date fund does not guarantee any income in retirement and has high costs. He suggests obtaining a Treasury bond



instead that only starts paying inflation-linked coupons at a participant's retirement date. This will provide a guaranteed income stream. The option is not very different from the bonds that exist today, and is a very low cost option. Because the bond will be outstanding, you can continue to buy subscriptions off of the bond, as long as the Treasury continues issuing a sufficient amount of this debt. John Sayour asked about those bonds that mature after retirement. Dr. Muralidhar explained that the coupons will start paying at retirement and buying additional bonds on the outstanding bond does not extend the maturity date, however the costs will vary. He argued that even if the guarantee was not in the statute, he would still recommend against using a target date fund. The bond option would be much more liquid, but you may want to allow customization for those who want to invest in stocks to obtain a higher return. However, he suggests the bond option as the default option. Michael Callahan mentioned that these bonds would be pre-tax but the Board is looking at a Roth as post-tax. Mr. Callahan asked about using State bonds rather than Treasury bonds. Dr. Muralidhar believes that State bonds would work just as well. The bond would have a maturity of 20 years of paying coupons. If you die before that, you bequeath to your family, but if you die after that, you may have a problem. It is very difficult for the government to issue a longevity-linked bond, so the 20 years needs to be linked to expected longevity.

Comptroller Lembo introduced David C. John, who is a Senior Strategic Policy Advisor at the AARP Public Policy Institute, a Nonresident Senior Fellow and Deputy Director of the Retirement Security Project at the Brookings Institution, co-author of the Automatic IRA, and co-editor of the 2009 book, "Automatic: Changing the Way that America Saves." Mr. John explained that in developing the Automatic IRA idea with Mark Iwry, he studied the uncovered population. The five groups that are most likely to under-save for retirement are women, minority workers, low income workers, young workers, and small business employees. These populations are more likely to move from job to job. These uncovered workers will not be likely to stay in the plan throughout their lifetime. He explained that he strongly disagrees with Dr. Muralidhar's feelings on auto-enrollment. He believes that this feature is very important for this uncovered population and studies have shown that it is a very effective feature for encouraging workers to save. Lower income workers are more likely to have variable income. Retirement savings plans for these workers should offer two different courses. A certain portion of their income could be sent to a long term retirement plan and another portion of their income could be sent to a short term savings plan, such as a passbook savings account. This would offer short term liquidity that is necessary for this population. Offering a Roth IRA and allowing withdrawals of contributions at any time may discourage people from looking at the product as a long term retirement savings plan. Therefore, having a short term savings account is also very important. The United Kingdom NEST program requires every business with two or more employees to offer a retirement savings program. The NEST program offers a public option for those businesses that do not have a private option. Some of the private providers have now gone in and offer competition to the public option because the market exists now due to the requirement.

At the beginning of most retirement plans, the plan started out as a very simple program before adding supplemental features. The Board can start with a low cost system before adding supplemental features. The NEST program is phasing the program in, by starting with larger businesses and slowly transitioning to including smaller businesses. There are fewer larger



entities with the most aggregate employees, so the processes are easier to establish while testing the system. The initial management and structure will be crucial. Adding features in a transitional process is the best way forward. Mr. John explained that there are many ways to offer an annuity. Annuities can be expensive and they are a fairly illiquid investment. Annuities should be looked at closer to the retirement date. The Board may want to consider longevity annuities as well, because they do not start distributions until around age 80 and they are much cheaper. Hopefully the markets will produce other, cheaper products as well. Mr. John believes the target date fund is a relatively imperfect instrument; however some providers are looking at replacing it with a better instrument. Mr. Sayour explained that some longevity annuities allow you to recover principal if you die before distributions start. The Board statute requires a joint and survivor benefit to the annuities. The Board could also require additional features. Deputy Commissioner Dennis Murphy asked what percentage of funds would be used to cover the administration and enforcement of the program. Mr. John stated there is very little information on these state plans for small businesses, but there is a lot of information on large industrial plans. Unfortunately, the populations are not the same and will have different behavior patterns. With the employer mandate and the auto-enrollment of employees, the Board could expect that many employees will remain in the default option.

Comptroller Lembo introduced Kathleen Kennedy Townsend, who is Managing Director at the Rock Creek Group, Founder to the Center for Retirement Initiatives at Georgetown University, Chair of the Governor's Retirement Security Task Force for the State of Maryland, Maryland's first woman Lieutenant Governor, and former Deputy Assistant Attorney General of the United States. Ms. Townsend explained that now 25 states have passed or considered legislation on this subject. Rhode Island is considering a simple mandate that everyone has a retirement plan, but leaving the options up to the private sector. The issues of auto-enrollment, employer mandate, and investment options have already been discussed. She explained how ERISA works with respect to enforcing consumer protections. Although states are trying to obtain an exemption from ERISA, it is actually a very important statute. Sometimes, states' legal protections are not equal to ERISA protections. One example she explained was a government worker who did not have spousal protections like he would if he worked in the private sector. But if a state creates a state legal framework that is comparable to the ERISA protections, that may be appropriate as a substitute. The Department of Labor will most likely pass a safe harbor provision for state auto-IRA plans outside of ERISA, but the providers and the funds will have fiduciary responsibilities and the employers will have the responsibility of remitting contributions to the fund. AARP has come up with best practices for these plans. There would be a Board of Trustees with fiduciary duties, auto-enrollment, dispute resolution mechanism, spousal protections, clear disclosures to employees and retirees, and high standards for the private vendors. Transparency and trust is very important, particularly with the lower income population.

The Mercer Global Pension Index measured how 25 countries emphasized adequacy, sustainability, and integrity in their pension plans. Many countries required an annual personal statement, while only nine countries include a benefit projection or estimate in the statement. Twelve countries require the asset allocation to be included in the annual report, while only four countries require it show major investments. Seven countries allow reimbursement when fraud occurs. Ms. Townsend believes that is a good feature to include to enhance the integrity of the program. Sixteen countries give members access to an independent review or complaints



process. The costs of pension systems are very difficult to figure out, because there is very little transparency in the direct and indirect fees that are charged to participants and sponsors. Since many people generally leave these issues to the experts, it is important that we include financial education to allow participants to better understand the program. Deputy Commissioner Murphy asked about Social Security statements. He asked if someone thinks the statements are in error, whether there is a formal appeals or hearing process. Mr. Sayour asked about the reporting of future income on a monthly basis, whether or not present value should be used. Comptroller Lembo indicated that in the 457 plan, they started reporting the present value of retirement monthly income. Sal Luciano asked if any of the other states had developed enforcement mechanisms as of yet to ensure contributions are remitted accurately and timely. Ms. Townsend responded that she believes ERISA already has adequate enforcement mechanisms, so she would prefer if states remained under ERISA. Ms. Townsend explained that she had a conversation with the Treasurers of Illinois and California, and they discussed implementing the program first with those employees who work for employers with automatic payroll. The number of employees that work for an employer is not a defining factor of ease of implementing the program, but whether or not the employer has manual versus automatic payroll is a much more significant factor in determining ease of roll-out. She discussed planning the roll-out of the plan in phases, with the easier implementation at the beginning and the addition of supplemental features after the initial roll-out.

Comptroller Lembo introduced Andrea Feirstein, who is a Managing Director with AKF Consulting Group formed by her in 2002, has advised thirty-three state entities on a wide range of 529 savings and prepaid matters, built and ran the proprietary 529 business for Citigroup Asset Management (now Legg Mason), was an investment banker with Salomon Smith Barney's Municipal Securities Division, was a bond lawyer with Brown & Wood, and serves on the Board of Directors of the NIPF. Ms. Feirstein explained that she would describe the lessons from the 529 plans and the parallels with the state retirement initiative. She has four key points. First, the states were the policy drivers that led to the creation of the 529 plans. Second, once the states had a federal solution, the flood gates opened for the college savings plan industry. The third lesson is that the entities charged with responsibilities for these programs were the ones to determine how to administer these programs, but they also took advantage of resources within government. Finally, the thriving public policy driven 529 plans reflect the economic interests of the private sector interests and the ease of contributing to these plans. The 529 plans began with twelve states looking to create trusts that were tax exempt entities. The IRS took a different view and caused years of litigation. The parallel is that the states now are driving this retirement plan initiative. The major impediment has been the concern with respect to ERISA, which is similar to the 529 roadblock of the IRS litigation. Eventually, the litigation was resolved in favor of the states and section 529 was promulgated. It allowed states to establish and maintain tax deferred plans for college savings. Many states in implementing section 529 offered additional beneficial features. Investment managers saw the opportunity for sticky assets and wealth managers saw the opportunity for asset accumulation for their clients. Section 529 plans consist of prepayment plans, which were the precursor to 529 plans; direct plans; and advisor plans, which require an advisor to invest in a plan.

Ms. Feirstein explained that with 529 plans, the states were very specific about what the governance would look like. They did not require feasibility studies like the retirement initiatives





occurring now. 35 states placed governance in a place that already had experience in investments, such as Treasurers' or Comptrollers' offices. However, 87% of the plans had a third party administrator as the operating body, rather than the plan being placed completely within state government. 529 plans pool contributions, which gives the participants access to investments they otherwise would not have access to. Ms. Feirstein believes that consumers will embrace a solution led by the states, that a favorable Department of Labor regulation on ERISA will result in success for these plans, that state governments have the inherent investment expertise necessary to successfully deploy these plans, and that states can achieve economies of scale through simplification and increased scale. Mr. Sayour explained his concern that the legislation for the Board is more restrictive than the 529 plans were initially. Ms. Feirstein explained that there still are rigorous rules around the 529 plans, however. The proposed regulations were published in 1998 and they are still proposed now. Ms. Townsend explained that the 529 plans are open to participants outside of the states where the plan is set up. She has been in contact with states that are considering joining for the purposes of establishing a public retirement program. Ms. Feirstein explained that another program was created under Section 529a, which is called the ABLE Act. It is a savings program for disabled individuals. The 529a plan restricts participation to those living within the state that established the 529a plan. However, the more assets you have the better scale and lower fees you will have, so it may be a good idea to develop agreements with other states to obtain larger purchasing power.

#### **D. Adoption of Meeting Minutes**

A motion was made by Mr. Luciano to adopt the Meeting Minutes of October 7, 2015. Ken Floryan seconded the motion. The minutes were adopted unanimously at 11:15 a.m. Jamie Mills abstained. Comptroller Lembo indicated that the next meeting on November 4, 2015 may run a little long. Mr. Sayour suggested starting that meeting at 8:30 a.m. instead of 9:00 a.m.

#### **E. Adjournment**

A motion was made by Deputy Commissioner Murphy to adjourn. Mr. Floryan seconded the motion. The meeting adjourned at 11:17 AM.