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Invested in America

October 30, 2014

Connecticut Retirement Security Board
Office of the State Comptroller
55 Elm Street
Hartford, CT 06106
Submitted via E-mail to OSC.CRSB@ct.gov

Attn: CRSB Request for Public Comment

Dear Board Members:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to respond to the Request for Public Comment issued by the Connecticut Retirement Security Board (CRSB). SIFMA represents the shared interests of hundreds of securities firms, banks and asset managers, many of whom have a significant presence in Connecticut. Many of our members provide various services to retirement plans, including advisory services, investment opportunities, and plan recordkeeping.

We agree there is a savings challenge in this country. Individuals need to save more for retirement and need to better understand the benefits of compounding interest, diversification, and not accessing retirement savings accounts for other purposes. Additional education is part of this process. Enhanced federal and state programs and incentives encouraging more employers to offer these plans and more employees to utilize them would also be helpful.

SIFMA strongly supports a new federal retirement program created by President Obama known as myRA (My Retirement Account). This payroll deduction program (www.myRA.treasury.gov), which will be rolled out in late 2014, is described as a "simple, safe, affordable" way to save for retirement. It is backed by the U.S. Government, has Roth IRA tax advantages, and is portable for employees. We would encourage the Board to fully evaluate this new federal program before creating an expensive state alternative.

While SIFMA supports the federal myRA program, we do not believe that a state-run plan for private sector workers is the right approach because of the significant issues discussed below. Before moving forward, the CRSB should consider, among other things, the substantial cost and liability of such a plan, the potential impact on the private market, and what factors other than access may be preventing workers from saving. That being said, we are happy to respond to some of your questions.

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[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. For more information, visit www.sifma.org.

Plan Design

Under this category, we would like to begin by raising some broader plan design considerations that fall under Question 7 ("Do you have any additional concerns about the plan design features?). We will then address some of your more specific questions on default contribution rate (Question 3) and pre-retirement leakage (Question 6).

(1) Before designing and implementing a new plan, we would strongly encourage you to consider whether there is a need for more retirement options or whether education about existing options would address the issue at substantially less cost. The market for retirement savings alternatives in Connecticut is robust and highly competitive. There are currently 25,833 individuals in Connecticut working in the securities industry and a total of 114,325 people in the State employed by entities falling within the broader category of finance and insurance. These industries all provide numerous fairly priced retirement savings options, including 401(k), 403(b), 401(a), and 457(b) plans as well as SIMPLE, SEP and traditional and Roth IRAs. Indeed, earlier this year, ThinkAdvisor rated Connecticut as the #1 state for 401(k)s in the country based on its concentration of strong plans, with plans measured on their design, management and performance.[2] For those without an employer option, IRAs are also readily available on-line and at most financial institutions in the State. SIFMA would recommend that the State consider increasing coverage by educating both businesses and individuals about the various options that already exist, including the new myRA plan.

(2) We would also suggest that the Board and any market feasibility study consider what factors other than access may be preventing workers from saving for retirement. If, for example, competing financial needs is the primary reason people aren't saving, then a new retirement system with an employee opt-out capability, however well-intentioned, would likely not address the problem.

(3) We would also strongly encourage you to structure any proposal in a manner that does not encourage employers with strong existing plans to switch over to the State provided alternative. The State is looking to enhance, not reduce, retirement savings. Offering options that encourage employers that are already providing retirement plans to re-evaluate their offerings does not satisfy that objective.

(4) We would further urge you to closely examine the many issues that arise from a guaranteed rate of return on investment. The volatility of the last six years is illustrative. To limit its liability, the State will likely have to select only very conservative retirement savings alternatives. Retirement money grows very slowly under these options. Such a conservative approach can also frustrate investors who are getting, for example, a 2% rate of return in banner stock market years.

(5) Question 3 asks about the appropriate default contribution rate. The response depends on whether the State is looking to replace an individual's income or just provide a small additional savings account. If replacement income is the objective, we believe a full 10% is the appropriate number, and a default contribution level of 3% of income would be grossly insufficient. A person contributing 3% of income per year for 40 years at a guaranteed rate

[2] http://www.thinkadvisor.com/2014/03/05/top-10-best-states-for-401k-plans?page_all=1

of return of 3% will generate replacement income of less than 10% of pre-retirement wages. Using these same assumptions, an individual contributing 3% for over 20 years will generate replacement income of approximately 5% of pre-retirement wages. The Board should consider the costs and risks of the program relative to these marginal levels of income replacement.

(6) Question 6 asks how to minimize early withdrawal/pre-retirement leakage. Leakage is, of course, a big issue. We would suggest the Board consider certain existing distribution rules on IRAs. IRAs under Federal law have a 10% excise tax penalty for distribution before age 59 ½ and a requirement that distributions begin by age 70 ½. In addition, it will be important to educate residents about the benefits of leaving the money in the plan until retirement age. Without proper education, participants that withdraw early could end up worse off than if they had saved money outside of an IRA.

Legal Issues

We applaud the Board for recognizing the need to obtain rulings from the Department of Labor (DOL) and the Internal Revenue Service before implementing any retirement savings plan. We, however, believe that it will be very difficult to obtaining a ruling that ERISA does not apply. We would encourage the Board to closely consider the following:

(1) The Department of Labor issued an Advisory Opinion to Connecticut Governor Malloy in 2012 which is of relevance here. Advisory Opinion 2012-01A[3] was issued in response to the State's attempt to provide health insurance coverage for certain private sector workers who contracted with the state. DOL advised that private sector employers are not governmental agencies or instrumentalities and that therefore a provision exempting governmental plans from ERISA did not apply. The analysis for coverage of private sector employees in a pension benefit plan should be comparable. Joe Canary, Director of DOL's Office of Regulations and Interpretations, seemed to confirm this at a June 2014 Oregon Retirement Savings Task Force meeting when he said, "Governmental plans have to provide benefits to employees of the government. So, even if the government is involved in a private sector plan, that would not make that a governmental plan."

(2) We believe that not only would ERISA apply to the State, but its obligations could well extend to each participating employer. DOL Advisory Opinion 2012-04A[4] found that, where a plan is made up of numerous employers with no "genuine organizational relationship," both the "persons who operate the arrangement" and "each employer sponsor" would be subject to ERISA's fiduciary provisions.

(3) There is additional guidance from the Department of Labor that would be applicable as well. While there is a safe harbor for certain payroll deduction arrangements, several requirements, including limited employer involvement, would need to be satisfied. Employer contributions are just one of the things that would presumably trigger ERISA applicability under this safe harbor. DOL's Joe Canary stated at the Oregon meeting referenced above, "[i]f the employer is making contributions into the arrangement, that from an ERISA perspective, it

[3] http://www.dol.gov/ebsa/regs/aos/ao2012-01a.html
[4] http://www.dol.gov/ebsa/regs/aos/ao2012-04a.html

is a very big indicator that the employer is establishing and maintaining that plan, is funding that plan."

(4) As you have recognized, the best way to make a proper determination on the applicability of ERISA is to get a written opinion from the US Department of Labor. The process is identical to the process that Connecticut went through with DOL that resulted in DOL Advisory Opinion 2012-01A issued to Governor Malloy. In order to have meaningful assurance on ERISA applicability, numerous questions should be asked, including but not limited to the following:

a. Would a plan established and maintained by a state, a state task force, and/or a state appointed board for private-sector employers and/or employees be exempt from ERISA as a governmental plan pursuant to ERISA section 4(b)(1)?

b. If structured as an IRA pursuant to section 408(a) or 408(b) of the Internal Revenue Code, would the program be exempt from ERISA as "completely voluntary" per ERISA regulation section 2510.3-2(d)(ii) if:

i. Employees are auto-enrolled with the ability to opt-out; or

ii. Contributions are auto-deducted from the employee's paycheck at a predetermined percentage; or

iii. The contribution rate is auto-escalated with the ability to opt out.

c. If not structured as an IRA pursuant to section 408(a) or 408(b) of the Internal Revenue Code, would the program be considered an employee pension benefit plan established or maintained by an employer and/or an employer group pursuant to ERISA section 3(2), and thus subject to the requirements of ERISA? If yes, would the program be treated as a single plan, a multiple employer plan, or individual plans maintained by each applicable private sector employer?

(5) Furthermore, ERISA was adopted in 1974 as a protective statute. The Board should consider the potential implications of developing a program outside the scope of those protections. Current private sector plans must fully satisfy ERISA. While ERISA compliance does mean additional costs, it also means additional guaranteed rights for plan participants, including, for example, portability and spousal protection. If ERISA is found not to apply, the Board may nonetheless want to ensure that persons saving under the State plan receive these protections.

(6) The Board also should be aware that many of the requirements of ERISA are repeated under the Internal Revenue Code**.** The Board will want to ensure that any IRS ruling addresses both tax and ERISA implications. The IRS has also noted that "[a]gencies have become increasingly concerned with the growing number of requests for governmental plan determinations from plan sponsors whose relationships to government entities are

increasingly remote." It is therefore considering defining what constitutes a governmental plan.[5]

Investment Options

With respect to your Investment Options questions, we would like to focus on questions 8 and 11.

(1) Question 8 asks what investments and style of management we would recommend to satisfy the statutory goals of the plan. Because the State will be acting as the plan sponsor, it will need to carefully consider who would be investing in this plan and determine what type of plan best suits this group's needs. Depending on the group's risk tolerance, this could include giving greater weight to passive or active investments.

(2) Question 11 asks about effective risk management systems. It is important to recognize the positive role ERISA has played in protecting plan participants in ERISA-covered plans. ERISA sets forth many requirements regarding prudence and risk management, including making timely contributions, mapping and defaulting investment options, analyzing and understanding plan expenses, reporting, and more. We would suggest the Board adopt a risk management structure consistent with ERISA regardless of DOL's determination on ERISA applicability. Liability and risk - for the state and for participants - do not disappear in the event that the plan is deemed ERISA exempt.

Costs and Fees

Costs and fees certainly play a role in any retirement savings plan. SIFMA encourages the CRSB to consider the following:

(1) SIFMA believes that the current private market is highly competitive, with many providers actively providing services for individuals and employers at an affordable rate. We would be happy to cite specific examples of existing products and services and their costs at the Board's request.

(2) It is difficult to discuss ways to estimate and minimize costs and fees without knowledge of the plan, its legal structure and its administrative processes. Some factors that will play a role in overall costs and fees include:

- Is the structure retail or institutional? A retail arrangement exists where a provider has a contractual relationship directly with an individual. An institutional arrangement exists where the contracts are between a provider and an employer or with the trust.

- Does the group structure have commonality of procedures at the program or employer level? For example, will payroll functions run through a central clearinghouse or from each employer to the provider?

[5] http://www.irs.gov/Retirement-Plans/IRS-and-Treasury-Request-Comments-on-Possible-Approaches-to-Governmental-Plan-Guidance-1

- What are the communication and educational needs of the plan participants?

- What is the demographic information?

- How many investment options are going to be offered, and what (if any) are the limitations on transfers between the investment options?

- Is there an ability to take out loans?

- Is it quarterly, weekly or daily accounting?

(3) Studies and fiscal notes on this issue provide a wide range of cost possibilities that should be factored into the discussion.

- Illinois was exploring an automatic enrollment payroll deduction IRA earlier this year[6]. The Illinois Treasurer's Office projected start-up costs of between $15 million and $20 million over a two year period.

- The fiscal note on Connecticut SB 249 focused primarily on lost tax revenue[7]. The initial analysis predicted $66.1 million -$165.2 million in lost revenue annually. When the bill was amended to make it a Roth IRA, the revenue loss could not be documented, as it "is dependent on the investment earnings of contributions to, and timing of withdrawals from, the Roth IRAs established under the amendment." We are not saying that this revenue loss isn't merited; we are simply saying its cost should be calculated.

- Once a plan is established, the State would incur ongoing operational, oversight, compliance and insurance costs. We are aware of two studies that have examined the cost of creating a state-sponsored plan. One study, authored by the Maryland Supplemental Retirement Plans (MSRP) in 2007, concluded that a "[S]tate sponsored voluntary accounts program is potentially viable but will require significant long-term state expense." A 2009 Washington State report estimated that a state sponsored basic IRA plan that provided retirement savings options to 20,000 participants would have start-up costs of $1.9 million and annual on-going state costs of almost $1.4 million. We understand the numbers are dated, but it is probably fair to assume that these numbers would have only increased over the years.

(4) Pension Benefit Guarantee Corporation (PBGC) premiums would also need to be taken into account if the program looks more like a defined benefit plan. All ERISA plans must pay an annual premium to the PBGC for insurance in the event the plan terminates with insufficient assets. The current rate for single employer and multiple employer plans is $35 per participant. In addition, there is a variable-rate premium that also applies to plans that have unfunded vested benefits. In general, this premium is $9 per $1,000 of underfunding.

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[6] http://www.ilga.gov/legislation/billstatus.asp?DocNum=2758&GAID=12&GA=98&DocTypeID=SB&LegID=78572&SessionID=85

[7] http://www.cga.ct.gov/2014/FN/2014SB-00249-R000276-FN.htm

(5) Insurance will likely be necessary to indemnify the board, protect against loss, and insure any guaranteed rate of return on investment. Fiduciary insurance alone is significant but necessary. According to FiduciaryInsurance.com, plan fiduciaries now surpass the medical profession as a target for litigation, the average claim has surpassed $800,000, and defense costs have risen 471% in the last five years[8]. Premiums are dependent on a number of factors including amount of coverage sought, amount of assets, number of participants, and type of plan.

(6) It may be challenging for the State to receive the benefits of economies of scale because the State will need to connect directly with many individual employers and each of their systems and employee mix.

Next Steps

Overall, retirement savings is an increasingly important issue for individuals, for the State, and for the country. We applaud both the legislature and the CRSB for exploring alternative ways to address the problem. We appreciate the opportunity to provide feedback to your questions and to share our concerns with state run retirement savings plans. As you continue your examination, we would encourage you to look closely at myRA, to explore additional tax incentives to encourage more employers to participate, and to consider possible partnerships with industry to highlight existing low-cost alternatives.

Thank you for your consideration. Please do not hesitate to contact me at 212-313-1311 or SIFMA's lobbyist, Pat McCabe at 860-293-2581 should you have any questions or want additional information.

Sincerely,

Kim Chamberlain
Managing Director and Associate General Counsel
State Government Affairs

[8] http://fiduciaryinsurance.com/Resources/index.htm