



April 3, 2012

The Honorable Kevin De Leon
State Capitol, Room 5108
Sacramento, California 95814

RE: Opposition to SB 1234, AS AMENDED

Dear Senator De Leon:

We are writing to express our opposition to your recently amended SB 1234. This legislation creates a state-run retirement savings plan for private sector workers and guarantees a set rate of return on investment. It mandates employers with five or more employees to automatically enroll their workers into the state-run plan unless a retirement savings option is already available at the workplace. Employers that do not comply would be subject to a penalty of \$1000 per employee.

While we applaud your interest in encouraging Californians to save for retirement, we believe that SB 1234 is a major step in the wrong direction. The state is already facing a massive unfunded pension liability for its public sector workers. In our view, this is simply not the time for the state to create and assume liability for any new plan for private sector employees, much less one which guarantees a set rate of return on investment.

In addition, the employer mandate in SB 1234 is highly problematic. Such a mandate is counter to purported efforts to make the state more business friendly. Employers in general and small employers in particular want and need the flexibility to offer the mix of compensation and benefits that best meets the needs of their employees. Requiring employers to offer a benefit that their employees may not value is not an effective use of these employers' time and resources. While employees may, for example, prefer different benefits or additional compensation, employers would be forced to offer this benefit, possibly at the expense of others, or face a sizeable penalty.

Moreover, we are concerned about the operational questions and potential liability issues the legislation raises. Employers are uncertain as to how they would interface with the newly created state entity. They are worried about compliance costs and potential liability. For example, the bill requires that employers "make the plan available." This mandate could be read to require a host of educational as well as record keeping requirements for every employee at the risk of significant litigation. In

addition, they face potential liability for administrative errors. Those employers that choose to provide matching funds or otherwise fail to satisfy certain federal safe harbor requirements would also be opening themselves up to ERISA liability.

While SB 1234 is concerning to the business community, it should raise red flags for the state as well. By creating a plan for private sector workers, the legislation would expose the state to new and substantial ERISA and IRS liability even if the intent of the bill is to be exempt. For example, under ERISA, the state would have a fiduciary duty to the plan participants. Among other things, it would need to ensure that the plan is properly managed, that plan options are appropriate and adjusted as necessary, and that plan expenses are reasonable. Plan participants could bring actions against the state if they believed the state was not meeting its obligations. In addition, the state would be liable for the breaches of other fiduciaries, and state employees making plan investment and management decisions could be held personally liable. While insurance, if available, may help reduce state out-of-pocket payments for breaches or other violations, it does not eliminate the state's or individuals' ultimate responsibility or liability. Furthermore, to limit liability exposure, the state would have to undertake substantial compliance monitoring to ensure that no prohibited transactions occur, that non-discrimination testing is done correctly, and that the necessary ERISA and IRS forms and filings are properly executed.

In addition, the state would be incurring substantial costs to provide this service. Initial costs would likely include, among other things, plan research and design, legal and tax expenses associated with obtaining IRS approval, legal costs associated with ensuring plan compliance with ERISA, plan marketing costs, and costs associated with the establishment of the California Secure Choice Retirement Savings Trust. We recognize that SB 1234 seeks to avoid or minimize such costs by requiring that they be paid with federal, private or philanthropic funds. We certainly cannot speculate whether such funds will be forthcoming, but we caution that these costs will likely be significant. As you know, several years ago, much narrower legislation had estimated startup costs of \$1.69 million over 24 months. Presumably, however, some costs, such as those associated with the creation of the Retirement Savings Investment Board itself, couldn't and shouldn't be passed on.

Once a plan is established, the state would, of course, 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), concluded that a "State 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 would have start-up costs of \$1.8 million and annual on-going state costs of almost \$1.4 million.

While we recognize that all plans are not the same, it is clear that no plan is cost free. At a minimum, it will take time for the plan to achieve self-sufficiency and the state will need to be careful that, in passing costs on to the investor, it doesn't price its product out of the market. In addition, SB 1234 would likely have substantially higher costs than other retirement proposals, given the size of the state, the employer mandate, and the guaranteed return on investment component.

Finally, the effort, liability and expense of SB 1234 are unnecessary given that California already has a robust and highly competitive retirement savings market. California financial services firms - which directly employ 536,000 workers in the state and indirectly employ countless others - currently offer a wide variety of retirement savings alternatives, including 401(K) plans, 403(b) plans, 401(a) plans, 457(b) plans, SIMPLE

IRAs, SEP IRAs, and traditional IRAs. Smaller employers and individual employees tend to gravitate to IRAs because they are low-cost, straightforward and easy to administer. SB 1234 would create a new state-run structure that would directly compete for business with a wide range of California financial services firms and retirement plan providers. This would directly affect the livelihoods of securities firms and individual brokers, insurance and life insurance companies and individual agents, plan providers and their employees, and others in the financial services industry.

For these reasons, the entities listed below must oppose SB 1234. We appreciate the opportunity to provide input on this legislation.

Sincerely,

American Council of Life Insurers
Association of California Life and Health Insurance Companies
California Chamber of Commerce
California Grocers Association
California Manufacturers and Technology Association
Financial Services Institute
Insurance Brokers and Agents of the West
Investment Company Institute
National Association of Insurance and Financial Advisors of California
National Federation of Independent Business
Securities Industry and Financial Markets Association