June 15, 2012

To: Members of the Assembly Labor Committee

From: Allstate Insurance Company
American Council of Engineering Companies of California
American Council of Life Insurers
Association of California Life and Health Insurance Companies
California Association of Health Underwriters
California Chamber of Commerce
California Farm Bureau Federation
California Framing Contractor's Association
California Grocers Association
California Independent Grocers Association
California Manufacturers and Technology Association
California Retailers Association
Financial Planning Association
Financial Services Institute
ING
Insurance Brokers and Agents of the West
Investment Company Institute
National Association of Insurance and Financial Advisors of California
National Federation of Independent Business
Pacific Life Insurance Company
Personal Insurance Federation of California
Plumbing-Heating-Cooling Contractors Association of California
Principal Financial Group
Securities Industry and Financial Markets Association
Small Business California
State Farm
The Financial Services Roundtable
Western Electrical Contractors Association

RE: Opposition to SB 1234, AS AMENDED June 13, 2012

The 28 organizations listed above are writing to express our strong opposition to 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 $250 per employee.

While we applaud Senator De Leon for 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, compliance costs and liability issues the legislation raises. ERISA applies to employee benefit plans unless the plan falls within an expressly stated exception. A recent U.S. Department of Labor opinion (2012-01A) makes clear that a government program with private sector participation does not fall within the government exception. Two other recent DOL opinions (2012-03A and 2012-04A) also strongly state that a plan of unrelated employers is not a multiple employer plan but a single employer plan with respect to each participating employer. This means that each private sector employer would be burdened with the cost of compliance and administration. Such costs would include reporting requirements – such as the filing of Form 5500, an annual actuarial demonstration that the program satisfies minimum funding standards, liability for underfunding under the ERISA rules, and responsibility for actuarial violations. The estimated actuarial valuation alone would likely cost each employer somewhere between $2,000 and $5,000 annually. Pension Benefit Guarantee Corporation (PBGC) premiums of $35 per person would also be required; if these premium costs, as described in greater detail below, are not subsidized by the government, then they would have to be paid for by the employer. Finally, each individual employer would be subject to fiduciary liability. While SB 1234 seeks to eliminate an employer's potential federal liability and responsibility, we do not believe that a state bill has that authority under ERISA or the Internal Revenue Code.

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 also 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 fiduciary insurance 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. PBGC premiums are one of the biggest ticket items in connection with 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 both single employer and multiple employer plans is $35 per participant. Proponents of the bill estimate the program will cover 7 million workers. <u>This means that PBGC premiums alone could total $245 million per year</u>. Either the state or the individual employers will have to pick up this cost. In addition, there is a variable-rate premium that applies to plans that have unfunded vested benefits. In general, this premium is $9 per $1,000 of underfunding.

There are obviously numerous other costs beyond PBGC premiums. Initial costs to study and develop the program and to obtain the necessary federal approvals would be significant. Such costs will likely increase dramatically if the program faces a legal challenge. While some of these costs could be offset by federal, non-profit or private sources, an annual Budget Act appropriation is also a possible funding mechanism.

Once a plan is established, the state would, of course, incur ongoing operational, oversight, and compliance 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 "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 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. SB 1234 would obviously be more costly as it contains a guaranteed return on investment, includes an employer mandate, and hopes to cover 7 million – not 20,000 – participants.

SB 1234 also requires the Board to procure several different types of insurance and secure private underwriting and reinsurance to manage risk and insure the retirement savings benefit. This too has a presumably sizeable price tag attached. Moreover, while insurance may assist in risk management, the ultimate responsibility rests with the state, either as an explicit or "implied" guarantee.

Liability and cost are significant considerations the state should take into account. While the bill sets aside one percent (1%) of the total program fund to administer the program trust, we believe it is highly likely that administrative, compliance, insurance, PBGC premiums and other costs will far exceed that amount.

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 cost effective retirement savings alternatives. 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 at a time when the state's unemployment rate is 11%.

For these reasons, we must oppose SB 1234. We appreciate the opportunity to provide input on this legislation. For additional information regarding duties, costs and liabilities please see attachment.

Cc: Senator De Leon

[Attachment- American Council of Life Insurers White Paper]