May 10, 2012

To: The Honorable Christine Kehoe, Chair of Senate Appropriations Committee
Members of the Senate Appropriations Committee

From: 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 Grocers Association
California Independent Grocers Association
California Manufacturers and Technology Association
California Retailers Association
Financial Planners 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
Pacific Life Insurance Company
Plumbing-Heating-Cooling Contractors Association of California
Securities Industry and Financial Markets Association
Western Electrical Contractors Association

RE: Opposition to SB 1234, AS AMENDED May 2, 2012

We are writing to express our 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 $1000 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 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 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. 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 some of these 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.

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) 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.

Pension Benefit Guarantee Corporation (PBGC) premiums also need to be taken into account. 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. Proponents of the bill estimate the program will cover 7 million workers. This means that PBGC premiums alone could total $245 million per year. 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.

SB 1234 also recognizes the need for insurance to indemnify board members, to protect against loss, and to insure the guaranteed retirement savings benefit. These are substantial costs that need to be carefully considered. 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. Premiums are dependent on a number of factors including amount of coverage sought, amount of assets, number of participants, and type of plan.

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 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 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 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]