DEPARTMENT OF FINANCE BILL ANALYSIS

AMENDMENT DATE: 05/02/2012
POSITION: Oppose

BILL NUMBER: SB 1234
AUTHOR: De Leon, Kevin

BILL SUMMARY: Retirement savings plans.

This bill would create the California Secure Choice Retirement Savings Program (Program) as a retirement savings vehicle for private sector workers who do not have access to retirement plans through their jobs. The Program would be administered by a seven-member board chaired by the state Treasurer.

FISCAL SUMMARY

This bill would create a retirement plan for private-sector employees that is intended to be self-sustaining. However, this bill has provisions that allow for an appropriation, which would likely be from the General Fund, to support the Program.

The California Secure Choice Retirement Savings Investment Board (Board) would be required to first conduct an initial market and feasibility study to determine if the Program is self-sustaining. Funding for the study would come from a non-profit, a private entity, federal funding, or an appropriation in the annual Budget Act. A similar bill introduced in previous legislative sessions would have required the California Public Employees' Retirement System (CalPERS) to conduct such a study and manage a retirement fund for private-sector employees. CalPERS estimated the cost of producing a feasibility study would be $1.7 million. (This bill does not require CalPERS' participation in the Program.)

If the Board determines the Program is self-sustaining, the Board then would need to, and be authorized to, receive outside funding or a budget appropriation until the asset base is built up to adequately fund administrative costs out of earnings. In previous legislation, CalPERS estimated that a similar program could cost $1.2 million in administrative and operating costs during the initial start-up years, not including marketing and advertising. By way of comparison, the state's Scholarshare Investment Board, from which the Board in this bill is modeled, manages a college-savings program with a 9-person staff and $2.4 million budget that is paid out of investment earnings.

Annual administrative costs also would be capped at 1 percent of assets, which may prove to be unworkable based on mandatory insurance costs. The federal Employee Retirement Income Security Act (ERISA) requires retirement-system sponsors to make annual premium payments to the Pension Benefit Guarantee Corporation (PBGC), a U.S. agency, to provide continued benefits in case the plan is closed and assets are depleted. The Program could be required to make payments to the PBGC under ERISA. The 2012 rates are $9 per worker or retiree in multiemployer plans. The author's office estimates that 7 million people would be affected by this bill. Assuming those workers are lower earners and make 3 percent payroll contributions, the Program could have $6.6 billion invested in the first year, according to the author's office. Based on an initial investment of $6.6 billion in the first year, the PBGC payments would amount to $63 million annually, or nearly 1 percent of Program assets. The bill also specifies that the Board must secure private underwriting to cover shortfalls if weak investment earnings do not provide sufficient income to provide the guaranteed interest rate to members' accounts. Life insurance companies

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Governor's Office:	By:	Date:	Position Approved_______
			Position Disapproved

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FISCAL SUMMARY (continued)

that offer guaranteed, conservative returns on annuity investments typically charge annual premiums of approximately 1 percent of assets.

Despite the bill's stated intent to shield the state from financial liability, the state ultimately could be responsible for benefit payments under federal law, putting the state at serious risk of billions of dollars in unfunded liabilities if investment performance falters under the Program. High administrative costs, particularly in initial years as the asset base is built up, puts additional pressure on the Board to achieve investment returns over and above what is guaranteed to be credited to employees' accounts, in order to cover insurance premiums and overhead. Though the stated interest rate is expected to be relatively low, the investment strategy needed will likely include a more aggressive and volatile asset mix. This, in turn, puts even more risk on the state to cover losses. The California State Teachers' Retirement System, for example, offers members a similar cash-balance program that guarantees a 3.75 percent return on members' accounts but invests the assets in the same strategy as its pension fund to achieve 7.5 percent earnings. Though the plan was fully funded as of June 30, 2011, it has recorded unfunded liabilities in 5 of its 11 years of existence, and as high as $1.5 billion. Under the cash-balance model, employees withdraw their entire account balance upon retirement, which can quickly drain assets and put additional strain on the system. Though the author is attempting to transfer the liability to insurance companies, there is risk that an insurance company will become insolvent and will not be able to pay claims.

This bill also would require the Employment Development Department (EDD), through its investigation and audit function, to ensure that eligible employers are offering the program to employees. EDD would be required to fine eligible employers that fail to offer the program a penalty of $1,000 per every employee unless remedied within 90 days of being notified of the violation. EDD also would be required to create an opt-out process for employees. EDD estimates $465,000 in one-time costs for mailing and form production costs. Because the bill requires EDD to absorb enforcement costs as part of its existing investigation and audit function, EDD has not identified additional costs for this activity. This provision may generate additional workload and require additional staffing.

COMMENTS

Finance is opposed to this bill because it could create pressure on the General Fund to pay for start-up and administrative costs for the Program should outside funding fail to materialize. The General Fund is unable to support new programs at this time. This bill also establishes a new board at a time when the Administration is focusing on reducing the size of government.

Additionally, this bill could create a multibillion-dollar liability for the state if investment returns fail to reach cover the guaranteed rate of return and administrative overhead. All private-sector, defined-benefit plans, including cash-balance plans, operate under federal ERISA requirements, which hold plan sponsors responsible for benefit payments, among other fiduciary obligations. Governmental pension plans for public employees are exempt from ERISA and operate under state laws. Whether a state-sponsored, defined-benefit plan for private employees would fall under ERISA requirements is an open question subject to legal interpretation.

This bill would expand the state's role into private sector retirement policy, which is historically the domain of the federal government. Efforts to strengthen private sector retirement security could be pursued through Congress. Existing federal law also provides for a variety of individual retirement accounts by which employers and private citizens can save for retirement.

COMMENTS (continued)

While a conservative-growth retirement fund may be appealing to some employees, the compulsory nature of the Program and low guaranteed yields would limit investment choices for employees who may have a higher threshold for risk and desire a more aggressive investment strategy. Because the Program is required for businesses that do not offer retirement savings plan to employees, there is nothing to prevent a business that currently offers its employees a more generous retirement plan from dropping it in favor of the state-sponsored plan. Additional burdens would be placed on businesses to administer the payroll deduction.

Specifically this bill:

- Establishes the California Secure Choice Retirement Savings Trust for the stated purpose of promoting greater retirement savings for California private employees in a convenient, voluntary, low cost, and portable manner.

- Creates a seven-member California Secure Choice Retirement Savings Investment Board to administer the trust. The Board would be composed of the Treasurer (chair), Director of Finance, Controller, an individual with retirement savings and investment expertise appointed by the Senate Rules Committee, a small business representative and a public member each appointed by the Governor, and an employee representative appointed by the Assembly Speaker. The Board would hire investment managers to oversee assets in the trust. CalPERS would be authorized, but not required, to bid on an investment management contract to invest the Program's assets.

- Requires any private business with five or more employees and that do not offer an employer-sponsored retirement plan, to establish a payroll deposit retirement savings arrangement to the Program.

- Provides that employers with more than 100 employees would be required to make the plan available to employees within 3 months after the Board opens the Program for enrollment. Employers with more than 50 employees would have 6 months, and employers with more than 5 employees would have 9 months to establish the payroll deduction.

- Creates nominal accounts for employees to make contributions. Employees would not manage their individual accounts; the accounts would be pooled, managed professionally, and credited at a stated interest rate, adjusted annually by the Board, and compounded daily. The stated interest rate would likely be tied to a 30-year U.S. Treasury bond rate. Employees would receive the balance of the account upon retirement.

- Mandates participation for employees unless they opt out of the Program through an EDD exemption form. The employee would be required to elect to opt out every 24 months or the employee would be automatically re-enrolled.

- Sets the default contribution rate for employees at 3 percent of salary or wages. The Board may adjust the contribution amount between 2 to 4 percent. Employer contributions would be optional.

- Stipulates that all costs of administration of the trust shall be paid out of the administrative fund, from earnings on deposits. The provisions of the bill become operative only if funds are made available through a nonprofit, private entity, or federal funding, or a state appropriation, in amounts sufficient to allow the Board to study, develop, and obtain the approvals necessary to implement the Program.

- Limits expenditures from the administrative fund to one percent of the total Program fund.

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COMMENTS (continued)

- Directs the Board to conduct a market analysis to determine the feasibility of the Program. Requires the Board to determine, through the study, if the Program is self-sustaining and report the finding to various legislative committees and the Director of Finance.
- Provides that the state “shall have no liability for the payment of the benefit” and requires the Board to secure insurance against investment losses.
- Creates a reserve account from excess earnings that can be used to credit accounts if the stated interest rate cannot be met from investment earning or to credit accounts with additional earnings when there is an actuarial surplus.
- Authorizes EDD, beginning January 1, 2014, to fine employers who fail to make the program available. The fine would be $1,000 per employee following a 90-day warning period.
- Requires the Board to issue an annual audited financial report to the Governor, Controller, State Auditor, and Legislature.

Code/Department Agency or Revenue Type	SO LA CO RV	PROP 98	FC	(Fiscal Impact by Fiscal Year) (Dollars in Thousands) 2011-2012	FC	2012-2013	FC	2013-2014	Fund Code
0950/St Treasurer	SO	No		----- See Fiscal Summary -----					0001
1900/PERS	SO	No		----- See Fiscal Summary -----					0001
7100/EDD	SO	No	A	--	C	465	A	--	0001