NEWS RELEASE

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ICI Calls on California Officials to Delay Action on ‘Secure Choice’ Retirement Plan

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Consultants’ Report on Feasibility Fails to Provide Adequate Analysis

Washington, DC, March 24, 2016—California officials should delay further action on the state’s proposed “secure choice” state-run retirement plan for private-sector workers until it conducts further analysis to address “unrealistic or incomplete” assumptions in a state-sponsored feasibility study, the Investment Company Institute (ICI) told the California state treasurer today.

The feasibility study, conducted by Overture Financial LLC, fails to fully consider the range of likely events that could raise the costs and undermine the feasibility of the program, ICI says in a letter to California State Treasurer John Chiang. ICI’s analysis indicates that the report doesn’t fully capture all of the program’s administrative costs—which will fall either on participants or on California taxpayers—and fails to consider workforce demographics and other factors that could reduce the program’s ability to expand retirement plan coverage.

“We share the state’s objective of increasing retirement plan coverage for private-sector workers, but believe that goal must be achieved in a cost-effective way that reflects the realities of the workforce and retirement savings,” says ICI General Counsel David W. Blass. “Unfortunately, the state is relying upon a flawed report in evaluating the program. California’s workers and taxpayers deserve a clear, complete analysis of the program—including all the likely scenarios that could increase costs and liabilities—before it is implemented.”

A more effective approach to enhance retirement coverage would build upon the national, voluntary private-sector system of tax-deferred employer plans, Blass notes. “Simple reforms on a national level can make retirement plans less costly and more attractive to employers, particularly smaller businesses, that don’t offer plans today,” he says. “Employers best know the characteristics of their workforces, and policies that cooperate with employers—rather than coercing them—present far more effective and efficient solutions for expanding coverage."

California's Consultant 'Fails to Provide Adequate Analysis'

Treasurer Chiang chairs the California Secure Choice Retirement Savings Investment Board, which is scheduled to meet on March 28 to decide whether to recommend moving forward with "secure choice," based in large part on the Overture report. The report calculates the financing needed to establish the state-run retirement plan, the plan's likely fees, and the time needed to recoup upfront costs.

Based on ICI's and independent research, ICI concludes that the Overture report "fails to provide an adequate analysis of the financial feasibility of the Program. We are concerned that Program participants or California taxpayers—or most likely both—will find themselves bearing unanticipated costs as a result of the Program."

Even under the report's assumptions, ICI notes, California's proposed retirement plan would cost participants an annual fee of 100 basis points (1 percent of assets)—more than the fees charged by equity mutual funds that hold 90 percent of the equity fund assets in private-sector individual retirement accounts (IRAs).

ICI's analysis finds that the Overture report:

- **Fails to fully capture the increase in costs if more workers opt out of coverage.**

"Secure choice" contemplates requiring employers that have elected not to offer their own retirement plans to automatically enroll workers in payroll-deduction IRAs. Automatic enrollment has helped boost workers' participation in private-sector 401(k) and other defined contribution (DC) plans. But that private-sector experience isn't likely to carry over to the state-run IRA program, ICI says, because of several factors:

- Private-sector plans that offer automatic enrollment also tend to offer other features—most notably employer contributions and loan features—that reward participation, enhance flexibility, and appear to boost participation. The California plan will not offer those features. "It is difficult to disentangle the impact of one plan feature in isolation and some of the results achieved with automatic enrollment [in private-sector 401(k)s] may also be reflecting the influence of other plan features," ICI writes.
- Private-sector plans often provide extensive educational programs to promote the importance of saving for retirement, explain investment options and risk-reward trade-offs, and inform participants on plan features. California employers that are mandated to participate in "secure choice" are unlikely to provide similar backing to encourage worker participation.
- Automatic enrollment has been analyzed in the context of existing 401(k) plans—plans established for workforces that are likely to value and demand retirement savings plans. ICI research shows that employers that choose not to offer retirement plans tend to have workforces that are younger, less likely to work full time, full year, and lower-earning—all characteristics that reduce workers' demand for retirement benefits. "Secure choice," by contrast, will target employers whose workers are likely to defer saving for retirement in favor of meeting current financial needs, saving for other goals, or paying off debt.

For these reasons, ICI believes opt out rates could be higher, and participation lower, than the baseline scenario in the Overture report. ICI's letter offers data suggesting that Overture's analysis fails to take full account of the impact of lower participation on the program's costs.

- **Assumes contribution rates that are not supported by survey data.**

The Overture analysis assumes workers will contribute 5 percent of their pay to "secure choice" IRAs. In survey data presented in the report, however, 64 percent of eligible workers said they were likely to contribute less than $100 a month—including 44 percent who would contribute less than $50. Based on respondents' maximum likely contributions, the average annual contribution would range from $1,000 to about $1,700—well below the $2,000 average account balance that Overture projects after the first year.

The Overture report acknowledges that reducing the assumed 5 percent contribution rate to 3 percent would increase the program's required financing from $89 million to $170 million—a 91 percent increase. ICI called upon the Board to analyze additional scenarios using a range of contribution and opt-out rates.

- **Overlooks incentives that could increase leakage from program IRAs.**

The Overture report assumes that "secure choice" participants would be expected to pay a total fee of 100 basis points (1 percent of assets) to cover operating expenses and recoup the program's start-up costs. ICI points out that 90 percent of equity mutual fund assets in private-sector IRAs are in funds that charge less than 100 basis points in operating expenses—and that private-sector IRAs offer more investment choices than the state-run plan contemplates. Workers will have a financial incentive to move their savings out of "secure choice" and into private-sector IRAs as they "may realize that they could find a far more attractive deal in the private sector, with additional investment choice, flexibility, and lower-cost options," the ICI letter states.

- **Fails to consider all the costs of the program.**

The Overture report does not appear to take into account the costs of enforcing employer participation, compliance with the program's rules, ensuring that workers are eligible to participate, or auditing the program. The report also fails to consider the full costs of providing participant education, account statements, and other communications. "Program costs may be higher than projected, which will burden Program participants or California taxpayers, or both," ICI writes.

State-Run Programs for Private-Sector Employees Are 'Misplaced'

The ICI letter also points out that the workers targeted by "secure choice" often have other, more pressing financial needs or savings goals. "Analysis of household balance sheet data indicates that households without retirement accumulations tend to face significant and immediate pressing financial stresses, which would only be heightened if they are automatically enrolled into these plans and a portion of their wage income is set aside into a retirement savings account," ICI writes.

Indeed, ICI says, "research and data suggest that these state initiatives are misplaced and that there are other more targeted changes at the national level that will be more effective at increasing access to payroll-deduction savings opportunities." Creating "a patchwork of state-run programs" would have "the potential to harm the voluntary system for retirement savings that is helping millions of American private-sector workers achieve retirement security.”
