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ICI Urges Governor Brown to Carefully Examine Legal and Economic Risks of "Secure Choice" Retirement Program

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If Implemented, Program Could Expose State to Lawsuits, Taxpayer Bailout

Washington, DC, August 8, 2016—California Governor Jerry Brown should carefully examine the costs and risks of legislation to implement the California Secure Choice Retirement Savings Program and stop it before it is implemented, the Investment Company Institute (ICI) said today. The program would automatically enroll private-sector workers who don’t have employer-sponsored retirement plans in a state-run plan funded through payroll deductions.

Though ICI supports efforts to improve retirement savings, the Institute warned in a letter to the governor that the ultimate cost of implementing the California Secure Choice Program depends on many factors, including the opt-out and contribution rates of enrolled workers; legal and compliance costs relating to various federal laws; administrative costs in setting up and maintaining the program; and potentially significant costs that may arise later if market returns generated by the program’s investments are insufficient to cover promised benefits to participating workers. California taxpayers or Secure Choice Program participants—or most likely both—will find themselves bearing unanticipated costs if the program advances, ICI cautioned. Although legislation authorizing the program limits the state’s liability, future state policymakers are likely to feel an obligation to cover any shortfalls or excessive expenses that the program incurs. Potential amendments to the legislation appear unlikely to affect ICI’s economic analysis of the program’s risks and costs.

"Secure Choice—as currently structured—does not present a viable means of expanding meaningful retirement savings for private-sector workers in California and carries tremendous risks that could put taxpayers on the hook for a bailout," said ICI President and CEO Paul Schott Stevens. "The analysis used to advance this legislation paints an overly optimistic picture of this program's success and dangerously understates the economic risks to the state of California. Implementing Secure Choice as it stands now could damage California's fiscal health and create a new financial liability for state taxpayers."

The Institute's letter conveyed strong support for efforts to promote retirement security for all American workers. ICI's mutual fund members have a unique role in promoting the future of America's retirement system. About half of defined contribution plan and individual retirement account (IRA) assets are invested in mutual funds, which makes the mutual fund industry especially attuned to the needs of retirement savers. ICI's legal and economic expertise enable the Institute to analyze the viability of the Secure Choice Program.

Secure Choice's Legal Obligations, Risks, and Costs Have Not Been Fully Considered

ICI's letter provides detail on costs and risks relating to legal questions that remain unresolved, including: how federal laws like the Employee Retirement Income Security Act of 1974 (ERISA) will affect the operation and cost of the program; and whether the investment structures contemplated by the Secure Choice Program would result in registration obligations, and costly compliance, reporting and disclosure obligations, under federal securities laws.

Each of these issues raises significant questions about the viability of the program and requires further examination before Secure Choice advances, ICI told the governor.

Federal requirements provide important protections, which private-sector retirement savers have enjoyed for more than four decades. However, these protections impose compliance costs, and it is unclear whether the state's analysis includes these costs, which all private-sector providers must bear. Either the state anticipates operating the program without these important consumer protections, or it has failed to consider significant compliance costs that may affect the viability of the program, ICI states.

ICI Questions the Financial Viability of Secure Choice

Today's letter also reiterated concerns from ICI's extensive comment letter to the California Secure Choice Retirement Savings Investment Board in March, analyzing the financial feasibility of the program. ICI pointed to four key risk factors that could affect the financial viability of the program:

Opt-out rates may be higher than anticipated: The California Secure Choice Retirement Savings Investment Board likely underestimated the number of participants who will choose not to participate, given that the projected participation rates are—in part—based on findings derived from private-sector experience that reflects plans with different plan designs and workforce demographics. The workers expected to be enrolled in California Secure Choice are younger, have lower wage and salary earnings, and are more likely to work part-time—all factors that are likely to reduce participation and increase costs in the plan.

Contribution rates may be lower than expected: California Secure Choice enrollees generally will have low earnings, which will limit their contributions because of other demands on their financial resources. Low levels of contributions will lead to accounts with small balances, making California Secure Choice more costly to operate.

Withdrawal and turnover rates could be high, keeping average account balances low and costs per account high: Financial hardships, job changes, and rules that permit individuals to change financial services providers at any time—these and other factors could lead to high levels of turnover and withdrawal activity and keep average account sizes small. California Secure Choice participants may realize that a private-sector account may be more attractive, further reducing participation and account size.

Administrative costs probably will be higher than estimated: The program will incur significant start-up and ongoing administrative costs, many of which have been ignored or not fully recognized. The legislature is seeking to cap administrative costs at 1 percent of program funds. If costs exceed that cap, however, the gap will need to be closed—either by raising fees on the very workers the program is intended to benefit, or through a bailout from California taxpayers.

Contemplated investment structures raise additional risk: ICI also pointed out economic risks California may face if certain investment structures are chosen. For instance, the "pooled IRA with reserve fund" under consideration would provide a "soft guarantee" to reduce but not prevent losses for enrollees. This "soft guarantee" creates the very real risk that a sustained negative market environment will exhaust any "surplus" earnings withheld from participants. In such circumstances, the state will be forced to either fund distributions from new contributions, reduce participants' account balances to cover investment losses, or seek a bailout from California taxpayers to cover the funding deficit created by the "soft guarantee," ICI warned.

A detailed explanation of the costs and risks associated with Secure Choice that require further analysis begins on page 2 of ICI's letter.
