INVESTMENT COMPANY INSTITUTE

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April 19, 2016

Submitted electronically to lois.court.house@state.co.us

The Honorable Lois Court
Chair, House Finance Committee
Colorado General Assembly
200 East Colfax
Denver, Colorado 80203

Re: House Bill 16-1403, Colorado Secure Savings Plan

Dear Chair Court:

I am writing to express concern about the potential unforeseen costs to Colorado taxpayers and retirement savers resulting from House Bill 16-1403. The bill would establish the Colorado Secure Savings Plan (the "Colorado plan"), a state-run retirement savings plan for private-sector workers in Colorado.

The Investment Company Institute[1] strongly supports efforts to promote retirement security for American workers. We understand and appreciate the interest shown by the State of Colorado in ensuring that its residents have sufficient resources for retirement and share the goal of increasing workplace retirement plan access. We also appreciate that the Colorado legislature faces a significant challenge in making an informed, sound assessment of House Bill 16-1403. Regrettably, proponents of state retirement programs for private-sector employees—like the Colorado plan—claim that such programs do not expose taxpayers to significant start-up and ongoing administrative costs. These claims often are based on data that exaggerate the financial feasibility of the programs. We are concerned that Colorado plan participants or Colorado taxpayers—or most likely both—will find themselves bearing unanticipated costs as a result of the Colorado plan.

The Colorado plan appears to be based on a similar program being considered by the California legislature, the California Secure Choice Retirement Savings Plan (the "California Program"). The Institute recently provided extensive comment on the California Program to the California Secure

[1] The Investment Company Institute (ICI) is a leading global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's U.S. fund members manage total assets of $16.9 trillion and serve more than 90 million U.S. shareholders.

Choice Retirement Savings Investment Board (the "California Board") in connection with its consideration of a report prepared by Overture Financial LLC, analyzing the financial feasibility of the California Program (the "Report").[2] As explained in the attached letter to California State Treasurer and Chairman of the California Board,[3] the Report did not adequately consider financial and legal risks that call into question the feasibility of the California Program.

Questions about the financial viability of the California Program apply equally to the Colorado plan and we urge caution as you consider House Bill 16-1403. We summarize below some of the key financial and legal risks the Colorado legislature must carefully study before considering a vote on House Bill 16-1403:

Financial Risks

The Colorado plan raises several financial risks to the taxpayers of Colorado, Colorado plan participants and service providers. The most significant of these are the share of covered employees that choose not to participate (opt-out rates), contribution rates among participants, withdrawal and turnover activity, and administrative costs. All four risk factors could affect the financial viability of the Colorado plan.

Opt-out rates may be higher than anticipated. The financial viability of retirement programs, like the Colorado plan, depend on the number of covered employees that will continue to participate after being automatically enrolled. High opt-out rates could significantly increase the cost of running the Colorado plan.

Assumptions about opt-out rates quite often are overly optimistic, in part because they typically are based on findings derived from private-sector experience. It is quite likely, however, that automatic enrollment in state retirement programs will not elicit the participation rates produced by automatic enrollment in voluntary private-sector retirement plans.

Plan design and workforce demographics are other significant factors that affect opt-out rates, as discussed in the letter to the California Board.[4] The workers in Colorado not currently offered a retirement plan at their current employer are younger, have lower incomes, and are more likely to work part-time than workers who are offered a plan (*see* the Exhibits at the end of this letter, Figure 1). All three characteristics of these workers are likely to reduce the likelihood of their participating in the savings plan.

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[2] The Report is dated March 17, 2016 and is available at www.treasurer.ca.gov/scib/report.pdf.

[3] *See* March 24, 2016 letter from the Institute to The Honorable John Chiang, California State Treasurer (the "March 24 letter"), available at www.treasurer.ca.gov/scib/comments/blass.pdf.

[4] March 24 letter at pp. 4-15.

Opt-out rates not only may be high, but could be distributed across employers in a way that could increase costs of maintaining the plan. The plan will likely incur costs for each employee who participates and for each employer. The fewer the number of employees who participate per employer, the higher the operating costs will be for the plan. Two examples are provided in the accompanying March 24 letter.[5]

Contribution rates may be lower than expected. Contribution rates will have a significant impact on the ultimate cost of running the Colorado plan. Low levels of contributions will lead to accounts with small balances. A plan with small average account balances will be much more costly to operate than a plan with the same overall level of assets but larger average account balances.

Given that the income levels of workers not currently covered by a retirement plan are quite low, the amounts that workers are likely regularly to contribute will also be modest. Participating workers with low levels of income would likely make small contributions and have small account balances because of the other demands on their financial resources. In this respect, one-fifth of Colorado workers who do not have retirement plans at their current employers have annual salaries less than $10,000, and half have annual incomes of less than $24,500 (Exhibits, Figure 2). Even if the legislation were to focus on the 56 percent of eligible workers who are full-year, full time workers, one-fifth of those workers have annual salaries of $21,000 or less and half have incomes of less than $35,265. These income levels are not likely to support contribution rates necessary to ensure the self-sustaining economic viability of the Colorado plan.

Income levels play an important determining factor in understanding retirement savings behavior. The data suggest that nationwide about three-quarters of private-sector workers without retirement plan coverage may be focused on other savings goals or experiencing other financial stresses.[6] The policy rationale underlying state initiatives, like House Bill 16-1403, does not give adequate consideration to the fact that retirement savings is not the beginning of the financial difficulties for many of these individuals. It also does not give due regard to the important role that Social Security plays in replacing earnings for U.S. retirees, particularly lower-income workers, who get high earnings replacement rates from Social Security.[7]

Withdrawal and turnover rates could be high, keeping average account balances low and costs per account high. There are several variables that would affect withdrawal activity and account turnover: (1) access to account balances for self-certified hardship withdrawals; (2) behavior at job

[5] March 24 letter at pp. 12-14.

[6] March 24 letter at pp. 25-26.

[7] The Congressional Budget Office reports estimated replacement rates from scheduled Social Security payments, and Social Security replaces a higher percentage of pre-retirement earnings for workers in lower-income households than it does for workers in higher-income households. See Congressional Budget Office, CBO's 2015 Long-Term Projections for Social Security: Additional Information (December 2015), available at www.cbo.gov/sites/default/files/114th-congress-2015-2016/reports/51047-SSUpdate.pdf.

change of participants in a mandatory automatic enrollment program; (3) IRA rules which permit individuals to change financial services providers at any time; and (4) realization by participants that a private-sector IRA may offer a more attractive investment opportunity.

All of these factors will affect the size of the average account in the plan. Plan participants, for example, may realize that they can find a more attractive retirement savings option in the private sector, with additional investment choice, flexibility, and lower-cost options. At year-end 2014, more than 90 percent of IRA equity mutual fund assets were in equity mutual funds with operating expenses of less than 1.0 percent, including 40 percent with operating expenses less than 0.50 percent.[8] All of these factors could be expected to lead to high levels of turnover and withdrawal activity and keep average account sizes small.

Administrative costs could be quite high. Implementing and operating the Colorado plan will result in many additional costs than those described above. These include enforcement costs, additional administrative costs related to invalid Social Security numbers, costs relating to the contribution patterns of part-year and seasonal workers, and the full costs of developing and delivering participant education materials, communication channels, and necessary reporting systems. These costs will create pressure on Colorado to find revenues to pay significant start-up and ongoing administrative costs—particularly if assumptions about participation, contribution and withdrawal rates do not meet expectations. The legislature needs to carefully consider who will pay all these costs before moving forward with House Bill 16-1403.

Legal Risks

The Colorado Plan raises many significant legal questions that need to be answered before moving forward with House Bill 16-1403 because they will directly impact the economic viability of the program and the risk to Colorado employers. These questions, which we also described in our November 15, 2013 letter to Mr. Grant Boyken responding to the California Secure Choice Retirement Savings Program Request for Information,[9] include legal questions about the application of the Employee Retirement Income Security Act of 1974 ("ERISA")[10] and federal securities laws.

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[8] *See* Figure 9 in the March 24 letter. Furthermore, if one analyzes the distribution of IRA mutual fund assets by total fund expense ratio, it also is clear that IRA investors concentrate their assets in lower-cost mutual funds. *See* "Statement of the Investment Company Institute, Brian Reid, Chief Economist, Hearing on 'Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees,' Subcommittee on Health, Employment, Labor, and Pensions Committee on Education and the Workforce, United States House of Representatives" (June 17, 2015); available at www.ici.org/pdf/15_house_advice.pdf.

[9] The letter is available at www.treasurer.ca.gov/scib/rfi/ici.pdf.

[10] ERISA imposes significant oversight, reporting requirements and fiduciary responsibilities on sponsors of such plans. Moreover, if ERISA were to apply each employer participating in the Colorado Plan could be treated as the sponsor of a single employer plan with individual reporting requirements and fiduciary responsibilities.

These same legal questions were recently outlined in a memorandum from the law firm K&L Gates to the California Board, dated March 17, 2016, as part of its analysis of the program being considered by California.[11] The memorandum acknowledges that the legal questions "cannot be definitively answered at this point." The memorandum goes on to state that because the California Program could be "considered an 'investment company' under the Investment Company Act, and other aspects of the Program could be regulated under the federal securities laws," "[t]his would require registration with the SEC and significant reporting and disclosure obligations, which could make the Program considerably more expensive to operate." These significant open legal questions require resolution before consideration of House Bill 16-1403.

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The Institute agrees with the importance of promoting retirement security for American workers. We share the goal of increasing access to payroll-deduction savings opportunities, but believe there are other more targeted changes at the national level that will be more effective at achieving this goal.[12] In our view, policies that cooperate with, rather than coerce, employers, who best know the demographics and needs of their workers, present far more efficient and effective solutions for expanding coverage. At a minimum, however, we urge you to undertake a careful, critical examination of the costs and legal risks inherent in establishing and administering the Colorado Plan before taking a position on this consequential piece of legislation.

If you need additional information or you have questions regarding our comments, please do not hesitate to contact me at (202) 326-5815 or david.blass@ici.org; Sarah Holden, Senior Director, Retirement and Investor Research, at (202) 326-5915 or sholden@ici.org; or David Abbey, Deputy General Counsel – Retirement Policy, at (202) 326-5920 or david.abbey@ici.org. We welcome the opportunity to discuss these comments further or to provide additional information to you and your staff as you work on this important issue.

Sincerely,

/s/ David W. Blass

David W. Blass
General Counsel
Investment Company Institute

Attachment

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[11] The memorandum is available at www.treasurer.ca.gov/scib/analysis.pdf.

[12] For a description of such targeted changes, *see* letter from Investment Company Institute to U.S. Department of Labor, dated January 19, 2016; available at www.dol.gov/ebsa/pdf/1210-AB71-00062.pdf.

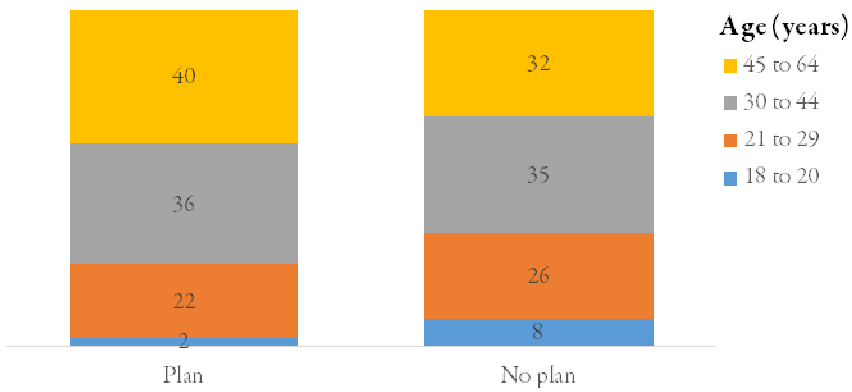
Exhibits

Figure 1

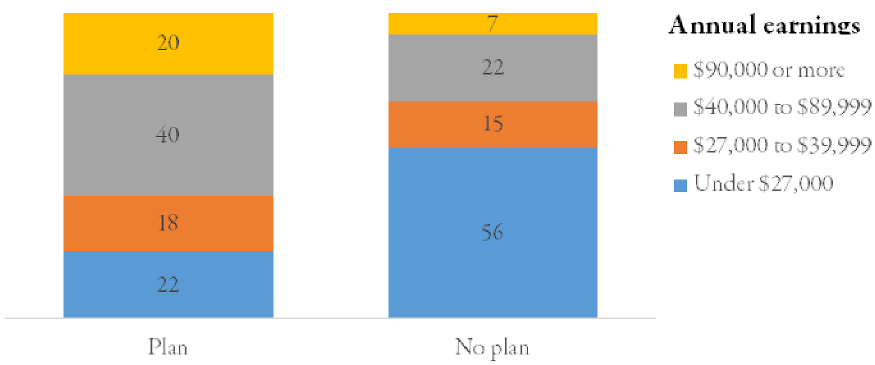
Workforces at Employers with Retirement Plans Differ from Those Without Plans

Percentage of private-sector wage and salary workers age 18 to 64 in Colorado, 2012–2014

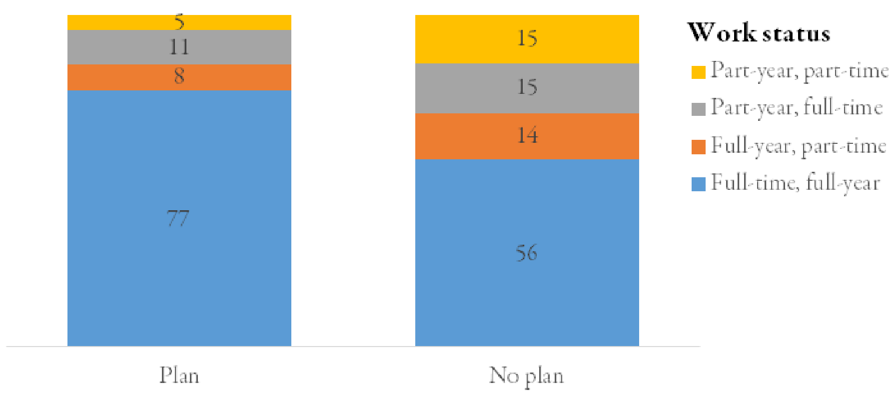
Workforces at employers without retirement plans tend to be younger



Workforces at employers without retirement plans tend to be lower-income



Workers at employers without retirement plans tend to be less connected to the employer

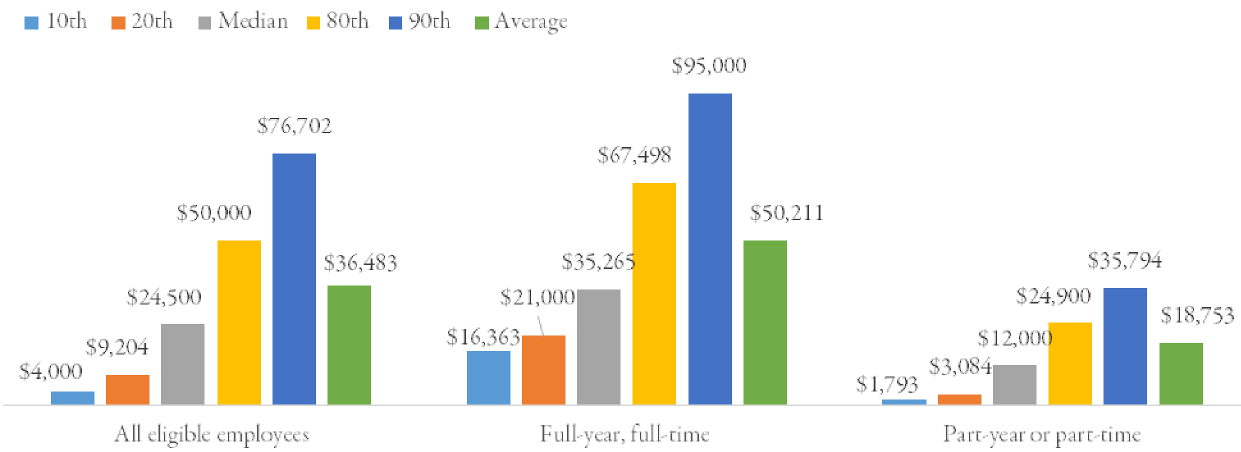


Note: The data indicate there are approximately 2.0 million private-sector wage and salary workers aged 18 to 64 in Colorado; about 960,000 (48 percent) of these workers are at employers that do not offer retirement plans.

Source: Investment Company Institute tabulations of the Current Population Survey

Figure 2

Wage Distribution of Eligible Colorado Employees
Percentiles and average of annual earnings, 2012–2014



Note: ICI tabulations indicate that 56 percent of eligible Colorado workers are full-time, full-year, and 44 percent are part-time or part-year (see Figure 1 above).
Source: Investment Company Institute tabulations of the Current Population Survey