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November 7, 2018

Ms. Irena Asmundson
Chief Economist
California Department of Finance
915 L Street
Sacramento, CA 95814

Re: Response to Department of Finance Comments on Standardized Regulatory Impact Assessment

Dear Ms. Asmundson,

Thank you for your comments on the standardized regulatory impact assessment (SRIA) developed for the proposed regulations for the CalSavers Retirement Savings Program ("CalSavers" or "the Program"). Please find our responses to each of your comments attached to this letter.

We appreciate the careful review of the SRIA and the assistance provided by Department of Finance staff.

If you have any questions, please contact me at (916) 653-1744 or by email at Katie.Selenski@sto.ca.gov.

Sincerely,



Kathleen Selenski
Executive Director
CalSavers Retirement Savings Program

Attachments: Response to Department of Finance Comments on SRIA

Cc: The Honorable John Chiang, California State Treasurer
Ms. Panorea Avdis, Governor's Office of Business and Economic Development
Ms. Debra Cornez, Director, Office of Administrative Law



Overseen by the
CALIFORNIA SECURE CHOICE RETIREMENT SAVINGS INVESTMENT BOARD

Response to comments on the Standardized Regulatory Impact Assessment (SRIA)

Date of Release: November 7, 2018

Summary

The California Secure Choice Retirement Savings Investment Board (Board) is in the process of adopting regulations to implement, interpret, and make specific the rules, policies, and procedures governing the CalSavers Retirement Savings Program (“CalSavers” or “the Program”).

In accordance with California Code of Regulations, title 1, section 2002(a)(1), the Board submitted a Standardized Regulatory Impact Assessment (SRIA) to the Department of Finance August 31, 2018. The Department of Finance (DOF) provided comments on the SRIA October 8, 2018. This document includes DOF’s comments and the Board’s responses to the comments.

Department of Finance Comments

On October 8, 2018 the Department of Finance provided the following response to the SRIA:

Thank you for submitting the standardized regulatory impact assessment (SRIA) and summary (Form DF-131) for proposed regulations setting up the CalSavers program, as required in California Code of Regulations, title 1, section 2002(a)(1) for major regulations. The proposed text of regulatory amendments dated August 31, 2018 and other publicly available information were also used in the development of these comments.

The proposed regulations would allow around 7 million workers in California at more than 200,000 businesses without an existing retirement savings plan to contribute to individual retirement accounts through payroll contributions. Employees for businesses with fewer than 5 workers would be excluded, along with the more than 500,000 in-home supportive services workers in California. The program sets automatic contributions to a Roth IRA of 5 percent of a worker’s wages unless they opt out, with an annual escalation of 1 percentage point per year until the contribution reaches 8 percent a year. The default investment option would be lower risk for the first \$1000, with contributions going to a target-date investment option based on the worker’s age after that. The SRIA assumes that 70 percent of eligible workers participate, and that 2.3 million participating workers will contribute \$3.5 billion in 2019, rising to 5.9 million workers contributing over \$15 billion by 2028. This will reduce take-home pay and hence sales taxes by about \$300 million by 2023. However, with administration fees for workers below 1 percent and assumed average investment returns of 5 percent, workers will be able to consume more after retirement.

Finance generally concurs with the methodology used to estimate impacts of proposed regulations. The SRIA is particularly clear in connecting the examples for individuals with the aggregate impacts, and in considering how the program will impact the low-income individuals who are likely to participate. However, the analysis must include a discussion of how administration costs and worker benefits may change if workers make early withdrawals from their accounts during recessions. Although many participants would have access to unemployment insurance after layoffs, many low-income participants would be likely to make early withdrawals. Accounts may have lost value, and withdrawals would prevent them from benefiting from rebounding asset prices and compound returns. Account administrators may also face higher administrative costs that must be recouped in higher fees.

These comments are intended to provide sufficient guidance outlining revisions to the impact assessment if a SRIA is required. The SRIA, a summary of Finance’s comments, and any responses must be included in the rulemaking file that is available for public comment. Finance understands that the

proposed regulations may change during the rulemaking process. If any significant changes to the proposed regulations result in economic impacts not discussed in the SRIA, please note that the revised economic impacts must be reflected on the Standard Form 399 for the rulemaking file submittal to the Office of Administrative Law. Please let us know if you have any questions regarding our comments.

California Secure Choice Retirement Savings Investment Board Comments

Employees for Businesses with Fewer than Five Employees

Department of Finance notes employers with fewer than five employees will be excluded from the Program. However, such workers will be able to participate in the Program as “Participating Individuals” and contribute to a CalSavers account through direct contributions outside of payroll contributions, as established under the proposed regulations.

Providers of In-Home Supportive Services (IHSS)

Department of Finance notes employers with fewer than five employees and the approximately 500,000 in-home supportive services (IHSS) providers will be excluded from the Program. The Board, Director of Finance, and Director of Social Services are currently evaluation whether IHSS providers can participate in the Program and are analyzing the logistical and fiscal considerations necessary to fully evaluate their participation.

Government Code Section 100046 compels the Board to include IHSS providers in the Program if it determines, and the Director of the State Department of Social Services and the Director of Finance certify in writing:

- their participation meets all state and federal legal requirements;
- the appropriate employer of record has been identified to satisfy the Program’s employer requirements;
- the payroll deduction necessary for participation can be done at reasonable cost; and
- the inclusion does not create a financial liability for the state or the employer.

The Board is currently working with both DOF and the California Department of Social Services to complete the analysis necessary for each party to make a decision. The cost analysis could not be completed until the Board had hired the third-party administrator (TPA), as costs may differ depending on the TPA’s technology and procedures.

DOF is correct that IHSS providers are currently excluded as employees in the Program in the traditional employment relationship. However, as noted above, such workers will be able to participate in the Program as “Participating Individuals”. Furthermore, as noted above, these individuals may eventually be able to participate through payroll deductions by participating employers if the provisions of Government Code Section 100046 are met.

Early Withdrawals

Retirement plans such as the IRAs offered by CalSavers receive favorable tax treatment because of the key role retirement savings play in an individual’s retirement security. There are both tax advantages to saving and disincentives for early withdrawals through additional taxes and fees.

Early withdrawals are likely to occur in any retirement plan. Participants may access their savings due to a pressing financial need, when they change jobs, or to roll over their assets to a new retirement savings plan. For the purposes of this addendum, any withdrawals made from a CalSavers account prior to age 59 ½ will be referred to as “early withdrawals.”

By some estimates, about 1% of retirement savings are withdrawn before reaching retirement age nationwide each year¹. CalSavers participants will likely include individuals with lower incomes relative to the current population of retirement savers nationwide. CalSavers participants will also likely have less knowledge or experience with retirement savings or other financial considerations than the current population of retirement savers. Accordingly, the population may be more likely to make early withdrawals.

The likelihood of heightened early withdrawals from CalSavers participants could be mitigated to some degree by the portability of the program. When a CalSavers participant changes jobs, they can continue saving in their CalSavers account through regular bank contributions or, if they work for another CalSavers-participating employer, continue saving through payroll deduction. Portability should not impact early withdrawals caused by financial need, but could reduce the likelihood of withdrawals due to rollovers or a job change.

CalSavers will not place any limitations on early withdrawals outside of what is regulated by federal law. While CalSavers will place no restrictions on an individual’s access to their funds, it will educate participants about the impacts of early withdrawals, including details about specific taxes and penalties and the impacts to an individual’s retirement security.

The Board selected Roth IRAs as the default IRA treatment. Contributions to Roth IRAs can be withdrawn early with no additional taxes or penalties—however investment earnings may be subject to taxes and additional penalties if withdrawn before reaching age 59 ½. While participants will have the option to use a Traditional IRA, the Board expects most participants will keep the Roth IRA type because it is the default account setting and because it may provide advantages for the population, which skews younger and lower-income.

Methodology

For this addendum, the authors use assumptions developed for the Board in the market analysis and feasibility study conducted in 2016. The market analysis and feasibility study considered the factors above in estimating early withdrawals, estimated a total of 3.5% of plan assets will leak out each year through rollovers, cash-outs, and pre-retirement withdrawals².

To analyze impacts on an individual’s retirement security, the authors calculated impacts of withdrawals of \$2,000 and \$5,000 made at various ages during a participant’s career. For the sake of comparison with the estimates in the SRIA, the authors used the savings scenarios developed in Tables 6 and 7 in the SRIA, which showed potential savings that could be accumulated for individuals that begin saving at age 25 and at age 35.

¹ Vanguard, (June 2018), [How America Saves 2018](#)

² Baki, M., Rhee, N., et. al., (2016), [Final Report to the California Secure Choice Retirement Savings Investment Board](#), Overture Financial LLC

To analyze impacts of early withdrawals on administrative fees, the authors calculated impacts of a 3.5% early withdrawal rate as well as 7.0%, 14.0%, and 25% to analyze impacts under a variety of scenarios.

Impact on Participants

Early withdrawals will impact a participant by potentially subjecting their savings to taxes and penalties and by impacting their retirement security through lost savings. However, early withdrawals may also provide some benefits to a participant by allowing them access to savings during a financial emergency.

The purpose of CalSavers, and tax-advantaged retirement savings vehicles like IRAs in general, is to encourage saving for retirement. Federal law allows for some exceptions to these taxes and penalties including disability, some higher education expenses, some unreimbursed medical expenses, health insurance premiums paid while unemployed, and qualified first-time home purchases.

Participants will eventually have the option to save all or a portion of their savings in a Roth or Traditional IRA³. The Board selected Roth IRAs as the default IRA type primarily because it is likely to result in better savings outcomes for the population, which skews younger and lower-income. The primary difference between a Roth and Traditional IRA is the time at which savings are taxed. In a Roth IRA, contributions are taxed in the year they are made, so investment earnings will accrue tax-free. In a Traditional IRA taxes are not applied until an individual makes a withdrawal, resulting in taxes applied to contributions and investment interest.

Early withdrawals of contributions from a Roth IRA— not any investment earnings — can be withdrawn without taxes or penalties. However, any withdrawal of investment earnings may be subject to income taxes and an additional 10% penalty.

Because the authors expect a majority of the eligible population to have little to nothing saved for retirement, any early withdrawal will likely have a substantial impact on their retirement security. The impacts will depend on the amount withdrawn, whether the withdrawals include investment interest, the age at which withdrawals are made, and investment performance, among other things.

Generally, the earlier a withdrawal is made, the greater the impact on retirement savings. This is due to the impact of compound interest on retirement savings. For example, in the hypothetical scenario detailed in Table 6 of the SRIA, a \$2,000 withdrawal at age 45 would result in a loss of a little less than \$6,000 in retirement savings by the time they reach age 65. If the same withdrawal is made at age 30, they would accrue about \$11,500 less than they would have if they hadn't make the withdrawal.

³ Traditional IRA will not be available as a program option until mid-2019.

Table 1. Comparison of expected savings with and without early withdrawals for participants beginning at age 25

Participants beginning at age 25				
Total Funds Available At Retirement	\$2,000 Withdrawal at age 30	\$2,000 Withdrawal at age 35	\$2,000 Withdrawal at age 45	\$2,000 Withdrawal at age 55
	\$337,881	\$340,388	\$343,893	\$346,044
Difference	(\$11,583)	(\$9,075)	(\$5,571)	(\$3,420)
Total Funds Available At Retirement	\$5,000 Withdrawal at age 30	\$5,000 Withdrawal at age 35	\$5,000 Withdrawal at age 45	\$5,000 Withdrawal at age 55
	\$320,505	\$326,774	\$335,535	\$340,913
Difference	(\$28,958)	(\$22,689)	(\$13,929)	(\$8,551)

These impacts on savings are detailed further for participants that begin saving at age 35, whose potential savings were modeled in Table 7 of the SRIA.

Table 2. Comparison of expected savings with early with and without early withdrawals for participants beginning at age 35

Participants beginning at age 35				
Total Funds Available At Retirement	\$2,000 Withdrawal at age 40	\$2,000 Withdrawal at age 45	\$2,000 Withdrawal at age 55	\$2,000 Withdrawal at age 60
	\$180,483	\$182,022	\$184,174	\$184,914
Difference	(\$7,110)	(\$5,571)	(\$3,420)	(\$2,679)
Total Funds Available At Retirement	\$5,000 Withdrawal at age 40	\$5,000 Withdrawal at age 45	\$5,000 Withdrawal at age 55	\$5,000 Withdrawal at age 60
	\$169,816	\$173,665	\$179,043	\$180,894
Difference	(\$17,777)	(\$13,929)	(\$8,551)	(\$6,699)

Many working individuals lack the ability to cover a financial emergency such as a medical expense, home repair, car repair, or expenses necessary due to a loss in income. A survey of working households by the Federal Reserve found about 44% of respondents lacked the resources to cover an unexpected \$400 emergency expense⁴. Households may cover expenses through borrowing from a family member, through credit card debt, or other means including early withdrawals from a retirement account.

While the purpose of the Program, and IRAs in general, is for retirement and not to serve as an emergency savings vehicle, early withdrawals may not be solely a negative impact for participants, as it could help an individual address an immediate financial emergency. The Program takes these considerations seriously and will use a variety of methods to educate participants about the importance of saving for retirement and the impacts of early withdrawals.

⁴ Board of Governors of the Federal Reserve System, (May 2018), [Report on the Economic Well-Being of U.S. Households in 2017](#)

Impact on Administrative Fees

There are three components to the fees charged on program assets: program administration, investment management, and the state administrative fee.

The program administration fee will be charged by the third-party administrator (TPA) and is necessary to pay for the majority of program costs, including recordkeeping, customer services, marketing, and mailing. The administration fee will be 75 basis points (bps), or 0.75%, at launch of the Program. The contract with the TPA requires the fee to reduce as the assets in the Program grow. When the Program reaches \$5 billion in assets, the administration fee will drop to 60bps. When the assets reach over \$10 billion, the fees would drop to 45 bps. The fees will continue to drop for each additional \$5 billion growth in assets, reaching a low of 15 bps, or 0.15%, when the assets reach \$35 billion.

The state administrative fee is necessary to pay for the State's share of costs necessary to operate the Program. Those costs include salaries for state employees—currently six, but growing to at least eight; consultant costs; external legal counsel; outreach and travel costs; and overhead costs including rent, technology, copiers, etc. The state has paid for its share of costs using a loan from the General Fund to be repaid after a six year period with interest calculated at the rate earned by the state's Pooled Money Investment Account⁵. The first loan amount of \$1.9 million plus interest will be due June 30, 2022.

At the October 16, 2018 meeting, the California Secure Choice Retirement Savings Investment Board approved a state administrative fee of 5 bps, or 0.05%. The fee was recommended by staff based on financial modeling using a range of assumptions including early withdrawals. Staff believe the fee would allow the Program to repay the loans and achieve net positive cash flow by year six of program operation, even under conservative assumptions.

The fees for investment management depend on the specific investment option. The Program will offer four investment option types and may offer a fifth investment option in 2019. The four investment option types include:

- Target-Date Funds, with fees of 9 bps;
- Global Equity Fund, with fees between 2 and 6.5 bps⁶;
- Core Bond Fund, with fees of 2.5 bps; and
- Capital Preservation Fund, with fees of 12 bps.

Investment fees will not directly be impacted by the size of the assets within the Program. Investment fees are subject to federal laws and restrictions and must be priced according to what is referred to as the "share class" of the specific fund, with the share class fees based on the size of the assets of an investor (in this case, the entirety of CalSavers participants). Because the program has already obtained pricing based on the most competitively-priced share class, the program's investment fees will not be impacted by the size of the program's assets.

Early withdrawals will have an impact on the pace at which the Program accrues assets, and therefore impact the pace at which the Program can reduce the fee for program administration. This impact,

⁵ [Senate Bill 826 - Budget Act of 2016](#); [Assembly Bill 97 - Budget Act of 2017](#); and [Senate Bill 840 - Budget Act of 2018](#).

⁶ The Global Equity Fund will combine a percentage of two different funds: State Street Equity 500 Index Fund and the State Street Global Equity ex-US index fund which charge 2 and 6.5 bps respectively. The funds will be blended monthly and fees assessed according to the percentage mix of each component fund.

however, should be insignificant even under adverse conditions. For this analysis, the authors evaluated the impacts of annual early withdrawals in the aggregate savings of all participants. Table 3 summarizes the total annual savings under various withdrawal scenarios ranging from zero to 25%.

Table 3. Comparison of Total Annual Savings under Various Annual Withdrawal Scenarios

Annual Savings - Contributions & Interest (Billions)										
Annual Withdrawals	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
0%	\$3.57	\$9.08	\$19.42	\$32.53	\$47.74	\$65.10	\$84.07	\$104.76	\$127.30	\$151.83
3.5%	\$3.44	\$8.64	\$18.31	\$30.33	\$43.49	\$59.16	\$75.39	\$92.72	\$111.23	\$131.01
7.0%	\$3.32	\$8.21	\$17.25	\$28.24	\$40.40	\$53.73	\$67.61	\$82.11	\$97.33	\$113.33
14%	\$3.07	\$7.98	\$15.75	\$24.83	\$34.42	\$44.54	\$54.62	\$64.76	\$75.08	\$85.67
25%	\$2.68	\$6.14	\$12.36	\$19.11	\$25.73	\$32.33	\$38.47	\$44.37	\$50.18	\$56.04

Even if 25% of assets leak out each year through early withdrawals, the Program would reach the first threshold for a fee reduction from 75 bps to 60 bps by the end of the second year of operation. By the end of the third year of operation, it would be able to reduce fees to 35 bps under scenarios with leakage up to 14% and would still be able to reduce fees to 45 bps with leakage of 25%. Under all scenarios, the Program could reduce fees to the minimum amount of 15 bps by the end of the seventh year of operation.

Conclusion

Some portion of CalSavers participants will inevitably take early withdrawals. This will negatively impact their retirement security, but could help some participants avoid a financial emergency. In total, early withdrawals will remove an estimated 3.5% of plan assets annually from the Program.

Participant fees will be reduced as the program’s assets grow. Withdrawals will impact the size of the assets saved under the Program. Because annual withdrawals are estimated to remove a relatively small portion of plan assets, at the same time additional assets will be contributed and investment interest earned, withdrawals should not significantly impact the program’s ability to reduce fees.