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# California to Move Forward with Auto-IRA Despite Loss of ERISA Safe Harbor

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On May 18, 2017, California State Treasurer John Chiang and Senate President Pro Tempore Kevin de León (D-Los Angeles) issued a press statement announcing that California remains on track to implement the California Secure Choice Retirement Savings Program ("Secure Choice" or the "Program"), a state-sponsored program requiring employers that do not offer workplace savings arrangements to establish an automatic payroll-deduction program to facilitate individual retirement account ("IRA") contributions by participating employees. (These programs are also referred to in this article as "auto-IRAs" or "auto-IRA programs.") California's announcement came on the heels of Congress passing joint resolutions (which were ultimately signed by President Trump) to nullify prior final regulations issued by the Department of Labor ("DOL") making auto-IRAs exempt from coverage under the Employee Retirement Income Security Act of 1974 ("ERISA"). Despite the reversal, California intends to fully implement Secure Choice, which is described on the California State Treasurer's Secure Choice website as being "*the most ambitious push to expand retirement security since the passage of Social Security in the 1930s*." This article addresses the background on auto-IRAs, the history of Secure Choice, the impact of the auto-IRA safe harbor and its reversal, and the effect on California employers.

## Background on Auto-IRAs

In recent years, prompted by the concern that millions of U.S. workers do not have access to workplace retirement savings programs, several states have enacted legislation establishing state-sponsored auto-IRA programs. In order to allow private-sector employees to contribute salary withholdings to IRAs, these programs generally require employers that do not offer workplace retirement savings programs to automatically deduct a specified amount of wages from employees' paychecks and remit those amounts to state-administered IRAs established for participating employees. These auto-IRA programs are intended to extend access to, and coverage under, the private retirement system, resulting in overall improvement in retirement security for countless U.S. workers.

To date, California, Connecticut, Illinois, Maryland, Oregon and Vermont are among the several states that have adopted legislation enacting state-sponsored auto-IRAs.

## The California Secure Choice Program

On February 23, 2012, the California legislature enacted Senate Bill 1234, establishing the California Secure Choice Retirement Savings Trust Act (the "Act"). The Act created the California Secure Choice Retirement Savings Trust ("Trust"), to be administered by the California Secure Choice Retirement Savings Investment Board ("Board"). Under the Act, the Board was instructed to design and establish Secure Choice for the more than six million California workers who lack access to retirement savings plans through their private-sector employers. The Act required that a feasibility study be conducted to determine the level of interest in the Program and whether it would be financially viable without the ongoing use of taxpayer funds.

On September 29, 2016, California Governor Brown approved amendments to the Act, which took into account the results of years of studies and expressed legislative approval of Secure Choice's implementation on January 1, 2017.

Although Secure Choice was scheduled to be implemented on January 1, 2017, an employer alert on the California State Treasurer's Secure Choice website recently provided that the Program will not go into effect for at least two years, with 2019 likely being the earliest year large employers that do not offer a retirement plan to their employees will be required to provide access to the Program. Once implemented, however, Secure Choice will require private-sector employers in California with five or more employees that do not already provide a retirement plan to either begin offering a retirement plan or provide their employees with access to the Program. Specifically:

- private-sector employers with more than 100 employees will be required to offer a retirement plan within 12 months after the Program becomes open for enrollment;
- private-employers with more than 50 employees will be required to offer a retirement plan within 24 months after the Program becomes open for enrollment; and
- private-employers with more than five employees will be required to offer a retirement plan within 36 months after the Program becomes open for enrollment.

In addition, employers will be required to automatically enroll all eligible employees in Secure Choice, unless an employee expressly opts out of participation.

Secure Choice is also intended to be operated in a manner that would impose limited responsibilities on participating employers, other than performing general administrative duties, such as enabling employees to make automatic contributions from their paycheck into their auto-IRAs, transmitting payroll contributions to a third-party administrator to be determined by the Board, and providing state-developed informational materials about the Program to eligible employees.

Moreover, the Board has made clear that there will be limits on employer liability under Secure Choice. For example, employers will not have any liability for an employee's decision to participate in, or opt out of, the Program, nor will they have any liability for the investment decisions of participating employees. Furthermore, employers will not be considered fiduciaries of the Program. More importantly, employers will not be able to contribute to their employees' accounts, as such contributions may trigger ERISA-coverage.

Overall, the intent of the fully operational Program, as articulated by the Board and California legislature, is to provide for auto-IRAs without subjecting Secure Choice or participating employers to ERISA-coverage and related potential liability thereunder.

## How ERISA-Coverage Can Extend to an Auto-IRA Program

To be an employee benefit plan covered by ERISA, a plan must be established or maintained by an employer or by an employee organization. Thus, if a plan or program is considered maintained by the employee, then it is not an employee pension benefit plan covered by Title I of ERISA. IRAs ordinarily are established by individuals without any employer involvement. As a result, IRAs generally are not subject to Title I of ERISA because they are not maintained by an employer.

Where an employer has a payroll deduction program that permits employees to contribute to IRAs, the DOL has previously ruled, under DOL Regulations Section 2510.3-2(d) and Interpretive Bulletin 99-1, that such IRAs are not subject to Title I of ERISA if certain conditions are satisfied, including the following:

(i) No contributions are made by the employer to the IRA (other than through payroll deduction, by which the employer simply transmits the contribution directly to the employee's IRA as a means of facilitating the employee's funding of the IRA);

(ii) Participation in the IRA is completely voluntary for employees;

(iii) The sole involvement of the employer is to permit the IRA-sponsor to publicize the program to employees, to collect contributions through payroll deductions, and to remit contributions to the IRAs; and

(iv) The employer receives no consideration in the form of cash or otherwise, other than reasonable compensation for services actually rendered in connection with payroll deductions.

Particularly relevant to the issue of ERISA-coverage is the "completely voluntary" requirement under (ii) above. The DOL has interpreted this requirement as precluding the use of an automatic enrollment feature. Accordingly, from the DOL's perspective, having an automatic payroll deduction IRA program would constitute the establishment of a plan for ERISA purposes.

## Auto-IRA ERISA Safe Harbor – Issuance and Reversal

Considering the influx of states establishing legislation requiring private-sector employers to establish auto-IRAs and the rising concern of employers that the automatic enrollment provisions of these programs would subject them to ERISA-coverage, the DOL issued final regulations that created a new safe harbor for auto-IRAs, which we previously reported on in our August 2016 Benefits Report. Under the final regulations, effective October 31, 2016, the DOL described the circumstances in which states could offer auto-IRAs without giving rise to the establishment of an employee benefit plan under ERISA. The DOL later expanded the safe harbor to cover political subdivisions, such as counties and cities, as described in our earlier newsletter. The objective of

the new safe harbor was to reduce the risk of auto-IRA programs from being preempted by ERISA, if ever challenged.

In February of this year, however, the House of Representatives ("House") took action to nullify the DOL's auto-IRA safe harbor by passing two resolutions revoking the safe harbor rule for both states and political subdivisions. Then in May of this year, following the House's action, the Senate voted in favor of passing a joint resolution overturning the DOL's auto-IRA safe harbor. President Trump ultimately signed legislation on May 17, 2017 that overturned the DOL's auto-IRA safe harbor rule in its entirety. As a result, states and political subdivisions that choose to sponsor auto-IRA programs currently have no assurance from the DOL that such programs are exempt from ERISA-coverage.

## California's Response

While the federal government has reversed the DOL's auto-IRA safe harbor rule, California has made it clear that such actions will not undo the work that has been done. In a press statement on the California State Treasurer's website, dated May 3, 2017, Treasurer Chiang said, "While I am deeply disappointed in this most recent example of the typical Beltway deal-making, which always seems to favor Wall Street bankers over Main Street workers, I am more resolute than ever to standing-up Secure Choice so that all Californians can have a dignified retirement."

Secure Choice is not intended go into effect until the program is fully operational, which may not be for at least another two years, as noted on the California State Treasurer's Secure Choice website. It will then be phased in over a three-year period. The goal is for the Program to begin operations sometime in 2018. That means employers with 100 or more employees that do not offer a retirement plan will be required to provide a retirement plan or access to Secure Choice in 2019. Employers with more than 50 employees will be mandated to participate within two years after the Program is open for enrollment, which is likely to be 2020, and within 36 months all employers with fewer than 50 employees will be required to participate. Therefore, the Program is anticipated to be fully rolled out in 2021.

California legislatures have indicated that although they intend to eliminate the reference to the DOL's auto-IRA safe harbor from the Act, the requirement that the Secure Choice program may not be an ERISA-regulated plan is expected to remain once the program is fully operational. During a press conference held on May 18, 2017, Treasurer Chiang stated that he has consulted with legislative leaders and legal counsel and is "*confident that California is on a strong legal footing in moving forward to make Secure Choice a reality*."

## Final Notes

Although the non-ERISA status of auto-IRAs has not been challenged in court, the private retirement community will be watching for how the ERISA-exemption argument holds for states, such as California, that are pressing forward with these types of programs without the DOL's auto-IRA safe harbor. Furthermore, it will be noteworthy to see if the loss of the DOL's auto-IRA safe harbor will discourage more states from joining California. Interestingly enough, the problem of inadequate retirement savings and the consequences of insufficient retirement planning are becoming

a significant economic burden on not just the states and political subdivisions, but the federal government as well. However, supporters of the DOL's auto-IRA safe harbor believe that the federal government, by revoking the safe harbor auto-IRA, has created an obstacle for private-sector workers by limiting opportunities to accumulate greater retirement savings.

We will continue to monitor the status of auto-IRAs and Secure Choice, and advise you of any significant developments.

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