The DOL Finalizes Its Safe-Harbor Rule on State-Sponsored IRAs

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On August 25, 2016, the Department of Labor (DOL) issued its final rule on the circumstances in which state payroll deduction savings programs with an automatic enrollment feature would not give rise to the establishment of an employee benefit plan under the Employee Retirement Income Security Act of 1974, as amended (ERISA) and, thus, ERISA coverage. The final rule provides states with safe harbor guidance in avoiding ERISA coverage and finalizes a proposed rule regarding this subject that was issued on November 16, 2015. The final rule becomes effective on September 29, 2016 (30 days after it was published in the Federal Register).

Background

According to a 2016 survey conducted by the U.S. Bureau of Labor Statistics, approximately 39 million workers in the United States (34%) do not have access to a retirement savings plan through their employers, based on a private-sector workforce of approximately 114 million. Although these employees could set up and contribute to their own IRAs, studies show that less than 10% of them actually do so. For older workers, the DOL notes that the lack of savings means sacrificing on food, housing, health care, transportation, and other necessities in retirement. For all workers, inadequate savings places significant stress on various state and federal social welfare programs.

In the final rule, the DOL explains that the concern over the low savings rates among American workers and the lack of access to workplace plans for many of those workers has led some state governments to expand access to savings programs by creating their own programs and requiring employer participation. To date, eight states — including California, Connecticut, Illinois, Maryland, and Oregon — have passed legislation creating state-mandated and sponsored retirement savings arrangements. These programs typically require employers that do not offer workplace savings arrangements to automatically enroll participants in a payroll deduction program and remit those deductions to state-administered IRAs established for the employees. (These programs are also referred to in this article as "auto IRAs" or "auto IRA programs.") The auto IRA programs, as currently designed, do not permit employers to make matching contributions to employee accounts. And, employers are required to provide employees with general information prepared as part of the program, including information on employees' rights and program features.

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The employers' concern about these auto IRA programs is that they (the employer) could be viewed as *establishing* the program, in which case it would be an ERISA-covered plan. This concern is based on ERISA section 3(2), which defines the terms "employee pension benefit plan" and "pension plan" very broadly to mean, in relevant part, "any plan, fund, or program…established or maintained by an employer or by an employee organization… to the extent that by its express terms or as a result of surrounding circumstances such plan, fund, or program provides retirement income to employees…" Both the DOL and the courts have broadly interpreted the words "established or maintained" to require only minimal involvement by an employer to make a program subject to ERISA and ERISA's broad preemption of state laws that "relate to" private-sector employee benefit programs, as well as the reporting and disclosure rules.

To address the ERISA disincentive to wider adoption of state auto IRA programs, the 2015 proposed regulations set out a framework from which states could operate in creating auto IRAs that would not be subject to ERISA. This proposed rule sought to create a safe harbor for states and employers that, if followed, would remove uncertainty regarding ERISA coverage. The DOL based the proposed rule primarily on a 1975 regulation under 29 CFR 2510.3-2(d) setting forth circumstances under which IRAs funded by payroll deductions would not be treated as ERISA plans, and also a 1999 Interpretive Bulletin clarifying that certain ministerial activities will not cause an employer to have established an ERISA plan as a result of simply facilitating a payroll deduction savings arrangement. In so doing, the DOL proposed a program under which private-sector employers who do not provide their employees with a retirement plan are required to automatically enroll them in IRAs to be administered by the state, subject to an employee's right to opt out of the program.

The proposed program was to be established and maintained pursuant to state law, and the employer could not make any contributions to the employees' accounts or perform any functions that were more than ministerial in nature, consistent with the 1999 Interpretive Bulletin. In addition, the employer would be required to provide employees with information regarding their rights under the program and allow vendors to provide employees with information about how the program operates. The DOL received approximately 70 public comments on the proposed rule.

The Final Rule

The final rule mostly follows the structure set forth in the proposed rule. Specifically, the rule provides that for purposes of Title I of ERISA, the terms "employee pension benefit plan" and "pension plan" do *not* include *(i.e.*, ERISA coverage does not apply to) an auto IRA program satisfying the following requirements:

- The program is established and maintained pursuant to State law, *requiring* employer participation in an automatic enrollment arrangement (if the employer has discretion as to whether to participate in the program, the safe harbor under the final rule is not available);
- The program is implemented and administered by the State (which includes a governmental agency or instrumentality of State), and the State remains responsible for investing the employee savings or for selecting the investment alternatives from which employees direct their investments;

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- The State assumes responsibility for the securing of payroll deductions and employee savings (the final rule clarifies that "[t]his condition does not make the states guarantors or hold them strictly liable for any and all employers' failures to transmit payroll deductions. Rather, this condition would be satisfied if the state established and followed a process to ensure that employers transmit payroll deductions safely, appropriately and in a timely fashion" — thus, the final rule does not provide a deadline by which employee contributions must be transmitted to the IRA);
- The State adopts measures ensuring that employees are notified of their rights under the program, and creates a mechanism for enforcing those rights;
- Employee participation is voluntary (*e.g.*, the employee must be given adequate advance notice of the right to opt out of the program at any time);
- All rights are enforceable by the employee or the employee's beneficiary/representative, or by the State;
- The involvement of the employer is limited to ministerial acts, such as: (i) collecting employee contributions through payroll deductions and remitting them to the program, (ii) providing notice to the employees and maintaining records regarding collections and remittances, (iii) providing information to the State necessary to facilitate operation of the program, and (iv) distributing to employees State program information;
- The employer makes no contributions to the program, nor does it provide employees with any monetary incentives for participating;
- The employer has no discretionary authority, control or responsibility under the program; and
- The employer receives no direct or indirect con–sideration for its participation in the program, in excess of an amount that reasonably approximates its costs under the program. (The proposed rule provided that employers could be reimbursed for no more than their actual costs for participating in the program. The final rule provides for a less stringent approach, by permitting reimbursements based on "a reasonable approximation of the employer's costs …".).

State programs that follow the safe harbor conditions set forth above will not be treated as ERISA-covered plans. It should be noted that the DOL makes it clear that nothing in the final rule should be read to prevent a state from establishing an ERISA-based plan, if it chooses to do so. In this regard, the DOL states in the final rule that "[a] safe harbor approach to these arrangements provides to states clear guide posts and certainty, yet does not by its terms prohibit states from taking additional or different action or from experimenting with other programs or arrangements."

The final rule removed a condition in the proposed rule that would have prohibited states from imposing any restrictions on employee withdrawals from auto IRA programs. This change came in response to comments arguing that the condition would have ill-advisedly interfered with a state's substantial interest in protecting against "leakage" (*i.e.*, the use of long-term savings for short-term purposes). The commentators also argued that such a provision might impair a state's

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ability to design potentially advantageous investment programs making use of diversified strategies, including investment and distribution options for which immediate liquidity is not possible (*i.e.*, options with guaranteed returns and annuities). The DOL concluded that this issue is better left to the states to determine in designing their auto IRA programs.

New Proposed Rule for "Political Subdivisions"

Interestingly, in connection with the issuance of its final rule regarding state-sponsored auto IRA programs, the DOL also issued a proposed rule that would permit larger cities and counties to provide auto IRA programs exempt from ERISA coverage. Essentially, the same state safe harbor requirements would apply to these programs; however, they would be only available to "qualified political subdivisions."

A qualified political subdivision would be any governmental unit of a state, including any city, county, or similar government body that met three criteria. First, the political subdivision must have the authority under state law to require employers' participation in the payroll saving program. Second, the political subdivision must have a population equal to or greater than population of the least populous state (currently, Wyoming with approximately 600,000 residents). (The DOL explained that this requirement was based on concerns that smaller political sub–divisions may not have the experience or expertise to administer a payroll savings program.) And third, the political subdivision cannot be within a state that has a state-wide retirement savings program for private-sector employees. This proposed rule is subject to a 30-day comment period.

Final Comments

Initial reaction to the final rule has been, as would be expected with almost any new ERISA guidance, somewhat mixed. While industry trade groups and others appear to generally applaud and support the fact that the final rule expands access to workplace retirement savings programs, some continue to be concerned about the fact that it creates favorable standards for payroll deduction IRA programs administered by a state, over those administered by private sector providers outside a state program. This appears particularly illogical to some because it fails to take advantage of the private sector's substantial experience in administering and distributing IRA products, and infrastructure it already has in place to meet both the state's and the DOL's goal of encouraging wide-spread and greater savings for retirement.

Proponents of offering a safe harbor alternative to auto IRA programs adopted by private sector employers assert that the limits placed on the employer's involvement under the final rule adequately address any concerns about extending an ERISA exemption to private sector auto IRA arrangements. So, it is argued, there is no reasonable justification for not extending the safe harbor to auto IRA programs operated by the private sector.

Also, concern continues to be expressed that state-based auto IRA programs may encourage employers, especially those that are smaller, to not adopt or discontinue their ERISA-based plans that include employer contributions. If this were to happen, the effects would be the elimination of ERISA protections and the potential for workers to miss out on an opportunity to accumulate greater savings for retirement.

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On a more positive note, the final rule offers a safe harbor exemption from ERISA coverage that can reasonably be anticipated to encourage states to adopt auto IRA programs. For example, just last week in California the Assembly passed legislation to adopt the California Secure Choice Retirement Savings Trust (Senate Bill 1234). The governor is expected to sign Secure Choice into law within 30 days of Senate approval. Regardless of whether the Bill is viewed as favorable, it likely does indicate what will become a trend across the nation.

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