

Final Department of Labor Rules Open the Door for States to Move Forward with Retirement Initiatives

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Most Americans with retirement savings build up their nest egg through workplace savings programs. This is no accident: the federal government has created a number of tax structures to encourage employers to offer plans for their employees, including 401(k)s, 403(b)s, and SIMPLE and SEP IRAs. Millions of Americans participate in these programs, which help to supplement Social Security income in retirement.

But nearly half of all U.S. workers do not have access to any type of employer-based account. Instead, these workers – who tend to work for small businesses at below-average wages – are left to fend for themselves. Technically, they can take the initiative and open an Individual Retirement Account (IRA) on their own, but a [mountain of evidence](#) has clearly shown that being enrolled in a workplace plan is far more effective at getting people to save. And among employer-based plans, those that automatically enroll workers and deduct a small amount of savings from each paycheck (with the option to opt out) do a [much better job](#) of encouraging savings.

Employers who do not offer retirement plans cite a number of reasons for that decision, but the main complaints are the burdensome rules and complex market for employer-sponsored plans. So, over the past decade, [many federal policymakers](#) have proposed streamlined ways to expand access to retirement plans that ask very little of employers. However, none have been adopted by Congress. The Obama Administration's Treasury Department was successful in establishing [myRA](#), a basic retirement account designed to get workers without access to a 401(k) to start saving, but since it was established via executive action and not legislation, it cannot require employer participation and has other limitations.

States concerned about the huge gap between the amounts their citizens are currently saving and what they'll need for a secure retirement have recently pursued solutions of their own. California, Connecticut, Illinois, Oregon, and Maryland have led the way by devising state programs that automatically enroll otherwise uncovered workers into an IRA-like product (often called "auto-IRAs," though some states have taken to calling their programs "Secure Choice"), and other states such as Massachusetts, New Jersey, and Utah are considering similar arrangements and other approaches to expand coverage.






This issue brief summarizes recently released federal rules creating new ways for states to expand retirement coverage for private-sector workers, and highlights the tradeoffs state policymakers will face when deciding which of these new avenues to pursue.

As states began passing laws and moving forward to implement programs, several important but unanswered legal questions regarding how these state initiatives interact with federal law have bred confusion and uncertainty. The key issue is whether the state initiatives will trigger employer liability under the Employee Retirement Income Security Act of 1974 (ERISA), the federal law that governs employer-sponsored retirement plans.¹ ERISA protections are essential for safeguarding employees' funds, but plan sponsors – especially small employers who do not have large, dedicated human resources departments – often find the rules confusing and onerous. The most challenging of these ERISA requirements for small businesses is the one that places a [fiduciary duty](#) on employers to ensure the retirement plan they choose for their workers is invested soundly.

In response to these concerns, on November 16, 2015, the Obama Administration's Department of Labor (DOL) released two important legal opinions that give states new options for expanding coverage while at the same time reducing the burden on employers. These opinions open the door for states to move forward along one of two distinct paths: a payroll deduction plan that avoids ERISA, or a more traditional retirement plan model that would fall under ERISA.

- I. A rule – which was [finalized](#) on August 30, 2016, and will go into effect on October 31, 2016 – that exempts from ERISA regulation state² programs that require employers to automatically enroll their workers (with an opt-out option) in *payroll deduction IRAs*. Since courts are the ultimate arbiters on this question, states that abide by this administrative “safe harbor” may still face legal challenge, but the regulation gives states more certainty than they had before.³ There are a number of proposed requirements for accessing this new safe harbor, including:
 - a. **The state must establish and administer the plan, and must assume responsibility for the security of payroll deductions and the selection of investment alternatives.** This means that employers cannot automatically enroll their workers in an IRA other than the state-run one. The state may delegate implementation authority to a government agency or board. And the state, or its instrumentality, may contract with “commercial service providers, such as investment managers and record-keepers, to operate and administer its program,” but cannot completely outsource its responsibility.

Many private IRA providers oppose this requirement since they are interested in serving this market without having to win a state contract.
 - b. **The state must mandate employer participation in the state-managed payroll deduction IRA.** States that establish a mandate are allowed to offer a payroll deduction IRA with automatic enrollment; however, only employers who are covered by the mandate can enroll their workers in the state plan using this key feature. Employers who choose to participate voluntarily, or who choose a private sector IRA plan, cannot enroll their employees using automatic enrollment. The regulation reasons that permitting the employer to automatically enroll its workers at its own behest would (1) allow the employer to exert “undue...influence or pressure to enroll” on their workers; and (2) could be construed as the employer “establishing” a plan, both of which could trigger ERISA. This requirement is somewhat problematic for states with mandates that only cover businesses over a given size (e.g., 25 employees or more in Illinois) since those employers not subject to the mandate will not be able to automatically enroll their workers even if they would like to do so.
 - c. **Employee participation must be “voluntary.”** Automatic enrollment satisfies this requirement as long as an opt-out option is included and the employee is given adequate notice of his right to opt-out. Automatic increases to the default contribution rate based on increases in pay – often called “auto escalation” – are also allowed. The proposed rule also included a requirement that the state program may not impose restrictions on savers' ability to withdraw or rollover their IRAs, but the final rule rescinded that restriction, reasoning that states should have the flexibility to offer investment options, like annuities, that may require limitations on liquidity.
 - d. **The employer role must be minimal and ministerial in nature.** Employers can have no role in enforcing employee rights under the program and cannot make contributions. Employer involvement is limited to collecting, remitting, and keeping records of employee contributions through payroll deductions; providing information to the state necessary to facilitate the operation of the plan (e.g., employees' contact information and current salary); and distributing program information to its employees.

THE STATES' NEW RETIREMENT CHOICES		
	STATE-RUN AUTO-IRA	STATE-SPONSORED OPEN MEP
PARTICIPATION 	<p>Since participation by employers can be – and in fact must be – mandated by the state, this approach will likely be best at providing retirement coverage for the broadest set of workers.</p>	<p>Since states can't mandate employer participation in an ERISA plan – even one that transfers many of the ERISA responsibilities to the state – it is unclear whether many employers who don't already offer a plan will decide to start as part of an open MEP.</p>
CONTRIBUTION 	<p>To access the safe harbor, the employer role must be severely circumscribed, meaning no employer match, which would otherwise help build employees' balances. Furthermore, contributions to IRAs are limited to \$5,500 per year.</p>	<p>Employers can make contributions of their own and much higher contribution limits apply (\$18,000 by the worker alone, and \$53,000 total versus \$5,500 for IRAs), though the higher limits may be of limited benefit to most low- and moderate-income workers.</p>
FEES 	<p>IRAs generally have higher fees than 401(k) and other ERISA-regulated plans, but states could use their bargaining power to negotiate for high-quality, low-fee products. Administrative fees can similarly be kept low, though this may be more challenging given the cost of servicing a large number of small-dollar accounts.</p>	<p>Open MEPs will have to abide by ERISA, which means robust fee disclosure rules. Historically, this has meant lower fees in ERISA-regulated plans than in IRAs. Also, depending on the size of the MEP, states could bargain for even lower management and recordkeeping fees.</p>
CONSUMER PROTECTION 	<p>IRAs generally have fewer consumer protections than 401(k) and other ERISA-regulated plans, but, under the new regulation, state-sponsored auto-IRAs must give savers legal recourse in certain situations and states are free to go above and beyond the safe harbor threshold to protect their citizens and their money.</p>	<p>Consumer protections in ERISA are robust and include safeguards that require plan administrators and investment advisors to act in savers' best interest, block creditors from accessing retirement accounts, and require spousal consent to change retirement account beneficiaries or payout plans. But legal questions remain as to how these protections will be enforced against states.</p>
BURDEN ON EMPLOYERS 	<p>To abide by the safe harbor, states are not allowed to ask much of employers. Recent advances in payroll technology make remitting money from a worker's paycheck to the state relatively easy. Employers may also be asked to distribute materials to their workers and provide information to the state, but they face absolutely no fiduciary liability.</p>	<p>A state MEP allows employers to delegate to the state or a state-chosen third party many of the administrative and legal responsibilities usually associated with offering a retirement plan. However, these employers would still retain some residual fiduciary responsibilities, making this approach slightly more onerous on employers than an auto-IRA.</p>

A full legal analysis of these requirements is outside the scope of this brief, but the main thrust is that the state must require employer participation, and the state must take responsibility for the integrity of the plan in order for the arrangement to be exempt from ERISA regulation.

- II. **An interpretive bulletin** – which went into effect immediately – that finds, in certain cases, states⁴ can facilitate or sponsor ERISA-covered retirement plans that relieve employers of some of the administrative and legal responsibilities usually associated with participation in an ERISA plan. The bulletin lists three possible approaches:
 - a. The first is a **marketplace structure**, in which a state establishes a voluntary program to connect employers with vetted savings plans. In these instances, the marketplace itself will not be subject to ERISA. New Jersey and the state of Washington are currently pursuing such an approach.

- b. The second is a **prototype plan**, in which a state designs an ERISA retirement plan for pre-approval by the Internal Revenue Service, which can then be adopted by multiple employers. Massachusetts is currently implementing such a plan for small, nonprofit organizations in its state.

The third and final approach – and the one this issue brief will most focus on – is a **state-sponsored “open” multiple employer plan** (MEP). Until this ruling, only a “closed” or “association” MEP – in which employers who share some pre-existing commonality offer the same plan to all of their workers and delegate administrative and fiduciary duties to an industry association that acts as plan sponsor – [was considered a “single plan” for ERISA purposes](#). The interpretive bulletin relaxes that requirement, allowing unrelated employers to form a single plan “open” MEP, but only if the new plan sponsor is the state.⁵ Being considered a single plan is important for limiting certain plan reporting, auditing, and bonding requirements, which reduces the administrative burden of offering a plan for employers. Proposals to similarly ease restrictions on privately-sponsored MEPs have been floated by [industry](#) and [Congress](#), but were not the subject of the interpretive bulletin and thus private open MEPs continue to be considered multiple plans. There is concern among [some observers](#) that this new MEP interpretation⁶ tilts the market against private providers, who are likely to seek legislation that would permit private single plan open MEPs, or to challenge the interpretive bulletin in court.

AUTO-IRA

Now that DOL has given its blessing to payroll deduction auto-IRAs, states like California, Connecticut, Illinois, Oregon, and Maryland will continue to pursue this method, but the approach has limitations.

PROS

- **High participation potential:** Combining an employer mandate with automatic enrollment is likely the best way to substantially boost coverage, since otherwise small employers and their workers will remain paralyzed by the status quo.
- **State as bulk purchaser:** In contracting with private investment management and recordkeeping companies, states can use the bargaining power that comes with running a large-scale program to ensure administrative costs and fees are kept low, which means more savings for participants.
- **State as new rule maker:** Though not covered by ERISA, states can of course write their own program rules, which can include robust consumer protections like fee disclosures, fee caps, and appropriate default investment vehicles and contribution rates.
- **Low administrative burden on employers:** Under the current system, employers – especially small businesses – often choose not to offer retirement plans to their workers because of complexity and cost. In addition to not triggering ERISA regulation, auto-IRAs require very little of employers – mostly just transferring money from a worker’s paycheck to the state-sponsored account, which, given recent advances in payroll technology, can be done relatively cheaply and easily.

CONS

- **Low contribution limits:** [Current tax rules](#) allow only \$5,500 in IRA contributions per year, compared with \$18,000 in 401(k)s and other ERISA plans (not including employer contributions, which can bring the total to \$53,000).⁷
- **No employer match:** Employer contributions will not be allowed under the new safe harbor. This severely limits the balance building and incentive effects that an employer match can offer (though some low- and moderate-income savers would still be eligible for the [Saver’s Credit](#), a government match through the tax code).
- **Fewer built-in consumer protections:** Though the Internal Revenue Code does place some important restrictions on IRAs, including rules regarding prohibited transactions like self-dealing, IRAs are more vulnerable to creditors’ claims and provide less protection to spouses in the case of divorce or death of the account holder than ERISA-covered plans. Moreover, many investment products in the IRA market have high fees that are not always well-disclosed.⁸

STATE-SPONSORED OPEN MEP

For those states that opt to stay within the confines of ERISA, the state-sponsored open MEP is one especially intriguing option. Though no states have started implementing an open MEP, some have expressed interest in pursuing it, including [Massachusetts](#).

PROS

- **Higher contribution limits:** Capping employee contributions at higher levels than IRAs (\$18,000 not including employer contributions vs. \$5,500) means more potential saving, though this may be of limited benefit to low- and moderate-income workers who are unlikely to build up annual savings above the IRA limit.
- **Employer match:** Since a state-sponsored open MEP is technically still an ERISA plan, employers can contribute and match their employees’ deposits.
- **Consumer protections:** For all its complexity, ERISA does provide well-worn channels for adjudicating savers’ complaints and plan sponsors’ malfeasance. Rules defining necessary disclosures, which help keep fees low, and protecting spouses in the case of divorce or their partner’s death are already on the books, so states would not be burdened with the task of reinventing the wheel.

- **Low administrative burden on employers:** A state MEP allows employers to delegate many of the administrative and legal responsibilities usually associated with offering a retirement plan to their workers. As in the auto-IRA context, the main remaining duty is accurately collecting and forwarding employee contributions, a fairly simple task for employers with electronic payroll systems.

CONS

- **Lower participation potential:** A state cannot require employers to join a state-sponsored open MEP,⁹ which means any increase in retirement plan coverage via a MEP will have to come from voluntary action by employers. Though surely some employers will jump at this opportunity, the vast majority likely will not.
- **Some employer responsibilities remain:** Though no longer a full-fledged fiduciary, employers participating in a state sponsored open MEP would still retain some residual fiduciary responsibilities, which may make this option less attractive for some.

ENDNOTES

1. There are two interrelated questions here: (1) if employers enrolling workers in the state plan will be treated as plan sponsors and thus regulated by ERISA; and (2) if the state's law will be preempted, and thus rendered moot, by ERISA. Though there are important legal distinctions between these two lines of inquiry, for simplicity's sake, this issue brief – which is more interested in the impact of the regulations than on their legal underpinning – will treat them as one in the same.
2. In an interesting development, DOL, on the same day it finalized this state safe harbor rule, published a [proposed rule](#) that would expand the safe harbor to certain state political subdivisions. Under the proposal, cities and counties with a population larger than the least populous state (currently Wyoming with 586,107 people) and in a state that does not already have a state-wide auto-IRA program would be eligible to establish a plan that qualifies for the safe harbor.
3. Note that this new safe harbor is different from a [previous one](#) issued at 29 CFR 2510.3-2(d) and clarified by 29 CFR 2509-99-1 regarding payroll deduction IRAs. It had been an open question whether that regulation, which allowed employers to enroll their workers – at the worker's behest – in payroll deduction IRAs without triggering ERISA, would protect employers who *automatically* enroll their workers in payroll deduction IRAs, but the new regulation seems to rule that out.
4. In a [separate proposal](#) published August 30, 2016, DOL clarified that their November, 2015, interpretation of ERISA as it regards state-sponsored retirement plans also applies to state political subdivisions like cities and counties.
5. The duty to prudently select the arrangement and to monitor its operation would continue to apply to employers, but the employer would not have to act as plan sponsor, plan administrator, or named fiduciary. It also would not have to file a Form 5500 Annual Return/Report.
6. The legal underpinning for this interpretation relies on two main arguments: (1) a state has a “unique representational interest in the health and welfare of its citizens” that allows it to act “indirectly in the interest of the participating employers”; and (2) state-sponsored open MEPs will not be preempted by federal law because the state is acting as a market participant, not as a regulator.
7. The IRA limit increases to \$6,500, and the 401(k) limit increases to \$24,000, if the saver is age 50 or older. The deductibility of traditional IRA contributions and the limit on Roth IRA contributions are reduced for certain high-income individuals.
8. The Obama Administration [recently attempted](#) to address these and other perceived shortcomings by more stringently regulating the IRA market.
9. However, states could establish an open MEP *in addition* to an auto-IRA, in which case employers would be required to provide some kind of coverage (as a result of the required mandate in the state's auto-IRA legislation) and might opt for the more robust savings limits associated with an open MEP.