Instant Insights

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By: Empower Retirement Legislative and Regulatory Affairs

Department of Labor Publishes Proposed Rule

DOL Publishes Guidance on State-run Retirement Programs

On November 16, 2015, the Department of Labor (DOL) published two pieces of guidance designed to make it easier for individual states to offer state-run retirement savings programs to private (i.e., nongovernmental) employers and employees. The guidance includes a Proposed Regulation that addresses IRA-based programs as well as interpretive guidance on employer plan-based programs.

Coverage Issue

The U.S. private defined contribution system has been extremely successful in helping many American workers save for retirement. American workers have collectively saved almost $10 billion for retirement in defined contribution plans, the majority of which was saved in 401(k) plans, and almost 77 million Americans participate in a 401(k) plan today.[i] There is, however, a "coverage gap" and the DOL estimates that 68 million working Americans do not have access to an employer- or payroll deduction-based retirement savings plan. Most of those employees either work for small employers or do not work full time.

There are many reasons why small employers are less likely to make a retirement plan available to their employees, but some key ones are cost, complexity, concerns with fiduciary risk, and the amount of administrative time and effort required to sponsor a plan.

Federal Efforts to Address

There have been numerous attempts by the federal government to address the coverage gap by offering solutions that, like ERISA plans, would be uniformly available across the country. President Barack Obama has included in all of his budgets an "Automatic IRA" proposal that would require employers who don't offer a plan to facilitate payroll deduction savings into IRAs for their employees. This proposal never gained support in Congress, but the Treasury Department did roll out the myRA program this year. That program is not mandatory and is not as robust a solution as the Automatic IRA proposal, so it remains to be seen whether it will make much of a dent in solving the coverage gap.

Congress has also proposed legislation and there is generally bipartisan support for improvements to employer plans that are intended to address the coverage gap. These proposals include ideas like requiring coverage of employees working 500 hours a year (as compared to the current 1,000-hour rule) and changing the rules regarding multiple employer plans (MEPs). A MEP is an arrangement whereby multiple employers join together into a single arrangement that allows them to offer a retirement savings plan to their employees with reduced cost, fiduciary risk and administrative effort. An "Open MEP" is a type of MEP that is treated as a single plan for ERISA purposes, including the ability to file a single Form 5500 for the entire arrangement. Under current DOL rules, Open MEPs are only available for arrangements where there is a "nexus," or relationship, among the participating employers in addition to a shared interest in providing retirement benefits. For example, an industry group like the American Bar Association can offer an Open MEP to its members, but a service provider cannot offer an Open MEP to all its small employer clients.

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State Initiatives and Concerns

In the absence of a federal solution and with the persistence of regulatory barriers to a private industry solution, many states began developing their own solutions. States are concerned about the impact on their residents, as well as the impact on their budgets, of having large numbers of workers enter retirement without sufficient savings to cover basic expenses, such as food, housing and medical care. There are a wide variety of approaches taken among the states and there is also a lot of variance in terms of how far along they are in the process of defining a solution. Two key legal concerns that states are concerned with are:

1. Will the arrangements be considered "ERISA plans," triggering application of ERISA's fiduciary, disclosure, reporting and other requirements (of particular concern to IRA-based programs)?
2. Will the state laws creating these programs be preempted by ERISA? ERISA is intended to provide for a uniform system of laws on retirement savings plans and one of the ways it does that is to preempt, or override, any state law that relates to an employee benefit plan.[ii]

DOL Guidance on IRA-based Programs

The Proposed Rule[iii] creates a safe harbor for IRA-based arrangements, allowing them to avoid being treated as ERISA plans sponsored by the employers participating in the arrangement. The safe harbor imposes conditions on both the state offering the program, as well as on the employers participating in it. The core intent of the conditions is to minimize the role of the employer while still providing adequate protections for participating employees. While the DOL cannot say definitively that compliance with the safe harbor conditions will avoid ERISA preemption, as that is a matter for federal courts to decide, the fact that these arrangements would not be employee benefit plans creates a strong argument for the conclusion that the laws creating them would not be preempted.

The safe harbor conditions for the state are:

1. The program must be established by state law and administered by the state.
2. The state is responsible for either investing the IRAs directly or for selecting investment alternatives for employees to choose from.
3. The state is responsible for the security of payroll deductions and employee savings.
4. Participation in the program is voluntary for employees. Automatic enrollment can be required as long as there is an opt-out right.
5. The state must adopt measures to ensure that employees are notified of their rights under the program and must also create a mechanism for enforcement of those rights.
6. The program does not require participants to retain any portion of their account in their IRA and does not impose any restrictions, costs or penalties on withdrawals that are otherwise permitted under the Internal Revenue Code.
7. All rights of program participants are enforceable only by them, an authorized representative or the state.
8. Employer involvement is limited to the safe harbor conditions for employers.

The safe harbor conditions for employers require that their involvement to be limited to:

1. Collecting contributions through payroll deduction and remitting them to the program.
2. Providing notice to employees and maintaining records regarding remittance of payroll contributions.
3. Providing information to the state as necessary to facilitate operation of the program.
4. Assisting in the distribution of information about the program.
5. Ensuring that employer contributions are not allowed and that there are no monetary incentives for employees to participate.
6. Requiring by state law the employer's participation in the program, as well as any automatic enrollment feature.
7. Ensuring that the employer cannot have any discretionary authority, responsibility or control over the arrangement.
8. Ensuring that the employer cannot receive any compensation other than reimbursement for actual costs of the program.

States are permitted under the safe harbor to hire service or investment providers to operate and administer their programs.

One of the concerns with the safe harbor is that it does not require that either the employer or the participating employee be a resident of the state offering the program. Another concern is that the safe harbor applies in circumstances where the employer offers a plan in which not all employees are eligible to participate. For example, an employer who sponsors a plan that has a 1,000-hours-of-service requirement may be required by state law to participate in these programs on behalf of its part-time employees.

Comments on the Proposed Rule are due by January 19, 2016. The effective date is scheduled to be 60 days after a final rule is published.

DOL Guidance on Employer Plan-based Programs

In a separate piece of guidance, Interpretive Bulletin 2015-02 (IB 2015-02), the DOL both describes how ERISA applies to certain employer plan-based arrangements and lays the groundwork for a court to conclude that the state laws creating these arrangements are not preempted by ERISA. The guidance addresses three types of arrangements. For all three, participation by employers must be voluntary.

1. Marketplace Facilitator: The role of the state in these arrangements is to create a marketplace (or hire a vendor to do so) where small employers can find high-quality, low-cost retirement plan solutions that are especially suited to small businesses. The marketplace arrangement itself would not be an ERISA plan, but any plan solutions offered in the marketplace that are subject to ERISA would continue to be ERISA covered.
2. Prototype Plan Provider: In this model the role of the state is to develop a prototype plan that individual employers could adopt. The individual employer would be subject to ERISA's fiduciary and other rules and would need to file individual Form 5500s, but the prototype plan document could designate the state or someone selected by the state to be the named fiduciary and plan administrator. The state could also designate low-cost investment options and a third-party administrator (TPA) for its prototype plans.
3. State-sponsored Open MEP: In what is likely to be the most controversial aspect of IB 2015-02, the DOL will allow states to act as plan sponsor, named fiduciary and plan administrator to an Open MEP. The role of individual employers joining the arrangement could be limited to executing a participation agreement, prudently selecting and monitoring the arrangement offered by the state, and forwarding employee contributions. The nexus identified by the DOL to permit states to offer these arrangements while still preventing others in private industry from offering them to unrelated employers is the state's interest in the health and welfare of its citizens.

There is no comment period for this guidance since it's considered to be an interpretation of existing rules rather than creation of a new rule, and it is immediately effective.

What's Next?

States looking to implement an IRA-based arrangement will most likely wait for a final rule to be published before rolling out their programs to ensure they satisfy the final safe harbor conditions.

The guidance on employer plan arrangements was based on laws that have been passed in specific states (Washington, Massachusetts and Maryland) so those states may move forward fairly quickly with rolling out their programs.

It is also possible that this guidance, which will result in a non-uniform system of retirement benefits to be offered across the country, may prompt Congress to make this issue a priority and develop a federal solution to the coverage gap.

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[i] SPARK 2015 Marketplace Update
[ii] ERISA § 514(a)
[iii] 29 CFR §2510.3-2

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