



update

Public Sector Benefits Compliance News

November 7, 2016

Federal Rule Helps States Move Forward on Retirement Savings Programs for Private Sector Employees

The Department of Labor (DOL) recently issued a final rule under which states can create programs that require employers to enroll employees in automatic payroll-deduction individual retirement accounts (IRAs).¹ The rule provides a safe harbor on how to structure these programs so they are not preempted by the Employee Retirement Income Security Act (ERISA).² The final rule, which took effect on October 31, 2016, provides flexibility and eases administration for states and employers as described in the section below. The DOL concurrently proposed an amendment to the final rule that would allow certain large cities and counties to establish similar programs under specific circumstances.³

Key Provisions of the Final Rule

The final rule:

- Clarifies that the safe harbor, which allows for automatic enrollment of employees, applies only if employers are required to participate in the state savings program;⁴
- Indicates that the program may be directed towards “*employers that do not offer some other workplace savings arrangement*”;⁵

¹ As noted in Segal Consulting’s September 1, 2016 website posting, “[DOL Green Lights State Savings Programs for Private Sector Employees](#),” the DOL issued the [final rule](#) on August 30, 2016.

² A safe harbor is a special provision that offers protection from violating a law provided the entity seeking that protection meets specific conditions.

³ The [proposed amendment](#) to the final rule was issued on August 30, 2016.

⁴ This new DOL ERISA safe harbor for certain state-sponsored savings plans is in addition to the 1975 IRA payroll deduction safe harbor for salary reduction IRA arrangements, which is still available. In both cases, arrangements that satisfy the specified requirements are not considered to be ERISA-covered pension plans, and therefore not subject to ERISA preemption. If a new state safe harbor plan permits participation by employers that are not otherwise required to participate, such employers can be protected by the 1975 safe harbor, provided that the state arrangement does not require auto-enrollment and otherwise satisfies the 1975 safe harbor.

⁵ This is a significant change from the language in the 2015 proposed rule that stated a program would not fail to qualify for the safe harbor merely because it is directed to “employees who are not already eligible for some other workplace savings arrangement” because the rule no longer implies that employers may need to monitor their obligations on an employee-by-employee basis.



Regulatory Guidance Highlights:

- DOL new final rule gives state retirement savings programs for private sector employees a safe harbor from ERISA preemption.
- The final rule allows design flexibility and makes changes intended to ease administration of these programs.
- A proposed amendment to the final rule would also allow certain cities and counties to offer their own savings programs.

NEW! On December 20, 2016, the DOL published a final rule permitting qualified political subdivisions (e.g., cities and counties) that meet specified criteria to establish their own retirement savings programs for private sector employees under the safe harbor finalized for states as described in [this Update](#).

On May 17, 2017, President Trump signed House Joint Resolution 66, which nullifies the rule discussed in [this Update](#). On April 13, 2017, he signed House Joint Resolution 67, which nullified the DOL’s companion clarifying rule for cities and other political subdivisions to establish similar programs. See our [hot topic](#).

- Allows costs to be determined according to a reasonable approximation of a typical employer's costs and to permit employers' costs to be defrayed through tax incentives and credits;⁶ and
- Explicitly recognizes it is a safe harbor, which does not preclude other types of arrangements that may also be exempt from ERISA, thus offering states flexibility in designing savings programs for private sector employees.

Moreover, the final rule removes one of the provisions proposed in 2015 that would have prohibited states from restricting withdrawals from the payroll deduction savings program. That change will help prevent retirement plan "leakage"⁷ and will encourage the availability and selection of lifetime-income options.

Otherwise, the final rule largely adopts the general structure of the 2015 proposed rule. (The DOL's final rule does *not* make any changes that affect the guidance in the DOL's November 2015 Interpretive Bulletin to assist states interested in helping employers establish ERISA-covered plans for their employees under three specific approaches.⁸ The Bulletin mirrored the types of plans already in development in various states.)

New Proposed Amendment to the Final Rule

The new proposed amendment would expand the final rule beyond states to cover programs of qualified political subdivisions that comply with the final rule. Under the new proposed amendment, "qualified political subdivision" includes a city, county or other similar governmental body that:

- Has the authority under state law to require employers' participation in a payroll deduction savings program;
- Has a population that is at least equal to the population of the least populated state (which is currently Wyoming with approximately 600,000 residents); and
- Is not located in a state that has established a state-wide retirement savings program for private sector employees.

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Programs Already Established in Selected States

Five states — California, Connecticut, Illinois, Maryland and Oregon — have already passed legislation that would require private employers to offer employees the option to make pretax contributions to a payroll-deduction IRA. Massachusetts has adopted a voluntary program that offers an ERISA-covered 401(k) plan to small nonprofit employers. The table on the next page compares details about these state retirement savings programs.

While the state payroll-deduction IRA programs differ in their design and stage of development, all faced uncertainty as to whether they would be preempted by ERISA. With the issuance of the final rule, those states now know how to finalize their programs to avoid a preemption challenge, at least from the DOL. However, the DOL warns that the courts will ultimately determine whether the safe harbor exception is permissible under ERISA.

⁶ This modifies a 2015 proposed provision that prohibited employers from receiving consideration from the state that exceeds their actual costs of complying with the payroll deduction savings program.

⁷ "Leakage" in a retirement plan means preretirement reductions of plan savings by employees, such as through loans, hardship withdrawals or lump-sum payouts at termination of employment.

⁸ The [Interpretive Bulletin](#) was also issued November 18, 2015. Segal's November 19, 2015 website posting, "[Guidance on State Savings Programs for Private Sector Employees](#)," briefly summarized the proposed rule and Interpretive Bulletin.

State Payroll-Deduction Retirement Savings Programs						
	CA	CT	IL	MA	MD	OR
Program Type	Payroll deduction to a traditional IRA	Payroll deduction to a Roth IRA;* option to change to a traditional IRA	Payroll deduction to a Roth IRA	401(k) plan subject to ERISA	Payroll deduction to an IRA	Payroll deduction to a Roth IRA
Covered Employers	Mandatory for all employers with 5+ employees that do not offer a plan	Mandatory for all employers with 5+ employees that do not offer a plan	Mandatory for all employers with 25+ employees that do not offer a plan	Voluntary for nonprofit organizations with 20 or fewer employees	Mandatory for all employers with 10+ employees that do not offer a plan	Mandatory for all employers that do not offer a plan
Automatic Enrollment	3% of pay with opt-out	3% of pay with opt-out	3% of pay with opt-out	6% of pay (unless employer chooses 4%) with auto-escalation up to 10% of pay	Default % determined by Board with opt-out	5% of pay with opt-out
Investment Structure	Target-date funds and other pooled accounts	Recommend 50% + of account in life-income investment	Target-date funds and other pooled accounts	Pooled accounts	To be determined by Board	Target-date funds and capital preservation funds
Current Status of Program	Legislation enacted 9/2012 established Board; legislation enacted 9/2016 to approve program	Legislation enacted 5/2016 to establish program with parameters	Legislation enacted 1/2015 to establish Board to administer plan with parameters	Legislation enacted 03/2012 to establish program administered by State Treasurer	Legislation enacted 5/2016 to establish program and incentive for employers	Legislation enacted 6/2015; program to begin mid-2017

* Contributions to Roth IRAs are not tax deductible, but withdrawals are tax exempt provided certain criteria are met. This savings vehicle is named for the Senator who championed the concept.

Source: Segal Consulting using information from the [Georgetown University Center for Retirement Initiatives](#)

New Jersey and Washington opted to provide an online exchange that informs individuals about retirement savings options offered by private-sector companies that are approved by the state. Under the exchange model, individuals voluntarily participate by selecting a retirement savings arrangement from a menu of plans. There is no employer involvement or mandate to enroll employees. Moreover, the exchanges are not covered under the DOL’s proposed or final rules.

The table on the next page compares the New Jersey and Washington programs.

State Market Exchange Retirement Savings Programs		
	NJ	WA
Covered Employers	Available to those with 100 or fewer employees	Available to those with 100 or fewer employees
Investment Structure	Target-date funds and a balanced fund	Target-date funds, a balanced fund and Treasury bonds
Current Status of Program	Legislation enacted 1/2016 to establish exchange under State Treasury with minimum parameters	Legislation enacted 5/2015 to establish exchange under State Commerce Department with minimum parameters

Source: Segal Consulting using information from the [Georgetown University Center for Retirement Initiatives](#)

In addition, a number of other states, as well as a few cities (e.g., New York, Philadelphia and Seattle) are considering legislation to offer retirement savings programs to private sector employees in their jurisdictions.

How Segal Can Help

Setting up a payroll IRA program is an enormous undertaking. For a mid-sized state, the number of employers that could be covered by the mandate could exceed 50,000 and the number of employees that could potentially be enrolled might exceed 500,000. For a very large state program, such as California, the potential number of eligible workers is estimated to be 6.8 million. For such a large and important undertaking, expert assistance can be critical. Segal Consulting has experience in the establishment of these programs and can assist potential program sponsors by:

- Analyzing and recommending both plan and program design features. Typical considerations for the plan design include eligibility, contribution targets, ease of participation, the benefit structure, and the potential for using “auto features.” (Auto features are described in the text box on the next page.) Program design is more operational in nature and looks at the nuts and bolts of communicating the program to covered employers and employees as well as the mechanisms associated with withholding and remitting payroll contributions.
- Designing a participant-friendly investment structure and advising on its oversight, monitoring and governance.
- Assisting with the request-for-proposal process to select service providers to conduct the various administrative and operational activities associated with operating a program of such potential size and complexity. Additional critical services include assessing the capabilities of potential partners to handle the onboarding of thousands of employers and assisting with the program enforcement including the identification of employers that are not in compliance with program requirements.
- Conducting an actuarial analysis of state savings that might accrue as the result of enacting a program. For example, an actuarial analysis can estimate potential Medicaid cost savings if a program were enacted.
- Evaluating the feasibility of the program from a cost/benefit perspective.

Jurisdictions should rely on their legal counsel’s advice on whether the program will comply with applicable federal laws and regulations, including the ERISA exemption safe harbor.

“Setting up a payroll IRA program is an enormous undertaking.”

What Are Auto Features?

Auto features consist of:

- **Automatic enrollment**, which means employees' pay is deducted by a percentage unless they affirmatively elect a different (or no) percentage of pay. This feature is specifically permitted under the final rule and many state programs include this feature.
- **Automatic escalation**, which means that the percentage of pay deducted increases at periodic times (e.g., annually) up to a maximum percentage. This feature is difficult to administer in a multiple employer program.
- **Default investment**, which means the investment fund in which the program deposits payroll deductions if an employee does not elect another investment option, and it is necessary if the program has automatic enrollment. Programs may choose a capital preservation fund for initial default investments and then move the assets to a long-term default fund after a period of time in order to minimize losses for employees who leave the program shortly after initial enrollment.

Questions?

For more information about how these new rules may affect your program or advice on how to establish a program, please contact one of the following experts or the [Segal office nearest you](#).

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