Insight

IN-DEPTH DISCUSSION

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Mandatory Payroll Deduction Savings Programs Are on the Rise

BY NANCY OBER AND SEAN BROWN

According to the U.S. Department of Labor (DOL), one-third of American workers do not have the option to participate in a retirement savings plan through their employers.[1] To help employees save for retirement, more states are passing or exploring legislation that requires employers to automatically enroll their workers in state-sponsored payroll deduction savings programs. The employee may then opt out, or change the beginning contribution amount, if the employee wishes to do so. Generally, this legislative trend affects only employers that do not offer access to an employer-sponsored retirement plan.

To date, five states have enacted automatic savings program legislation, each in varying stages of implementation. Similar laws are pending in three other jurisdictions. Additional states have enacted laws to create voluntary programs or marketplaces of retirement savings options.

Adoption of state payroll deduction savings programs for private-sector employees has up to now been impeded by uncertainty about whether state or local legislation creating such programs would be preempted by the Employee Retirement Income Security Act of 1974 (ERISA). To remove this impediment, the DOL recently issued a final rule providing that individual retirement plans established and maintained pursuant to a state payroll deduction savings program will not be treated as employee pension benefit plans under ERISA if specified "safe harbor" requirements are met. The DOL has also issued a proposed rule that would extend this ERISA exemption to such programs established by subdivisions of states, such as cities and counties.

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1 U.S. Dep't of Labor, Employee Benefits Security Administration, News Release (Aug. 25, 2016), https://www.dol.gov/newsroom/releases/ebsa/ebsa20160825.

Enacted Automatic Enrollment Legislation

Five states—California, Connecticut, Illinois, Maryland, and Oregon—have passed legislation providing for automatic enrollment in a state payroll deduction savings program, as summarized below. Employers with operations in those states that do not offer their own employee retirement plan should prepare to comply.

California. The California law, SB 1234, signed by Governor Brown on September 29, 2016, creates the California Secure Choice Retirement Savings Program. This legislation had been percolating since 2012, when the state established the California Secure Choice Retirement Savings Investment Board ("board") to explore the feasibility of implementing this type of savings plan. The California Security Choice Retirement Program will take effect on January 1, 2017, and will be administered by the board.[2]

The program mandates automatic payroll deductions into individual retirement accounts (IRA) for private-sector workers who work for employers that (a) have five or more employees and (b) do not currently offer a retirement plan. An automatic 3% minimum deduction will be made through the employee's payroll into his or her IRA, which will be managed by the board. Employees may opt out of the program or change their contribution levels at any time. Employers will have some minimal administrative duties but will not be a fiduciary with respect to the program nor have any liability for employees' decisions to participate or opt out, or for employees' investment choices. Employers retain the option to set up and offer a tax-qualified retirement plan instead, such as a defined benefit pension plan, a 401(k) plan, a simplified employee pension (SEP) plan or an automatic enrollment payroll deduction IRA. Compliance deadlines depend on the size of the employer; for example, employers with 100 or more employees must participate within 12 months after the Board opens the program for enrollment, while employers with less than 50 employees have three years to comply.

Connecticut. The Connecticut Retirement Security Program, HB 5591, was signed into law on May 27, 2016. As part of the program, the Connecticut Retirement Security Authority (essentially a nine-person board of directors) will begin work on January 1, 2017 to oversee implementation of the plan, which should roll out in 2018.[3]

The Connecticut law establishes Roth IRAs for covered employees, who must have worked for a qualified employer for at least 120 days and who must be at least 19 years old. A private-sector employer is covered if it (a) does not offer its own retirement plan and (b) employs at least five people who each earned at least $5,000 in wages in the prior calendar year. The Connecticut program mandates a 3% default payroll contribution, but employees can change their contribution rate or opt out altogether. On or by January 1, 2018, covered employers must give existing employees informational materials, which will be provided by the Connecticut Retirement Security Authority. All new hires must receive the same information within 30 days of their start date.

Illinois. Illinois enacted its automatic savings program on January 4, 2015, and it took effect on June 1, 2015. The Illinois Secure Choice Savings Program Act, SB 2758, will create a trust that will include the IRAs of enrolling employees. The program will be administered by the Illinois Secure Choice Savings Board and, barring any funding problems, must be implemented by June 1, 2017.[4]

The Illinois program covers private-sector employers that (a) have 25 or more employees, (b) have been in business for at least two years, and (c) do not currently offer an employment-based retirement plan. Smaller and newer employers may also participate if they choose. Employers can also elect to sponsor a retirement

2 The text of California SB 1234 can be found at: http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201520160SB1234.

3 The text of Connecticut HB 5591 can be found at: https://www.cga.ct.gov/2016/ACT/pa/2016PA-00029-R00HB-05591-PA.htm.

4 The text of Illinois SB 2758 can be found at: http://services.statescape.com/textarchive/billtextarchive/ssbilltext2014/IL20132014/IL_20132014_SB_002758_Current

plan rather than participate in the Illinois Secure Choice Savings Program. For participants, the program mandates a default contribution rate of 3%, although employees can change that rate or decline enrollment at any time. Employers are obligated to arrange for payroll deductions, to hand out promotional materials, and to designate an open enrollment period at least once a year. Employers must have the payroll deposit system operational within nine months after the Illinois Secure Choice Savings Board opens the program for enrollment.

Maryland. The Maryland version of a state-run retirement plan, created by SB 1007 and HB 1378, was signed into law on May 10, 2016, with an effective date of July 1, 2016. As with similar programs, the law creates a savings board to implement and maintain the program. Among other things, the board will establish the process for enrolling employees automatically and will select a default contribution rate.[5]

The program covers employees who are at least 18 years of age and are not eligible to participate in a tax-qualified retirement plan or other employment-based retirement savings plan. Maryland private-sector employers are required to participate if they: (a) pay employees via a payroll system or service, (b) do not currently offer a savings plan, and (c) have not offered a savings plan in the preceding two calendar years. Employers are excused if they were not continuously in business for the entire current and preceding calendar years. As an incentive, Maryland will waive the $300 annual business filing fee for participating employers.

Oregon. Oregon's law, HB 2960, took effect on June 25, 2015, and calls for a state-sponsored retirement savings plan to become available to eligible employees. The statute establishes the Oregon Retirement Savings Board, within the office of the state treasurer, to develop and administer the savings plan. Pursuant to the law, the board must get the plan up and running in time for employee contributions to begin no later than July 1, 2017.[6]

Employers are obligated to participate in the Oregon program if they do not offer a qualified retirement plan. As with similar state plans, employers will play a limited but critical administrative role by providing information to employees and arranging for payroll deductions. Employers will not be required to match contributions. The Oregon Retirement Savings Board intends to implement the program in phases over several years, beginning with larger employers in July 2017.

Enacted Voluntary Marketplace Legislation

Three other states have codified a voluntary approach to retirement savings.

Massachusetts. Massachusetts's legislation, HB 3754, was enacted on March 22, 2012. The law introduces a state-sponsored 401(k) for non-profit organizations with 20 or fewer employees. The state treasurer, along with a defined contribution committee, administers the program. The program, which falls under ERISA, is voluntary for both employers and employees.[7] As of June 2014, the Internal Revenue Service had ruled favorably on the Massachusetts proposal.[8] The treasurer's office is in the process of implementing the program as it works with the IRS.

5 The text of the Maryland law and its history can be found at: http://mgaleg.maryland.gov/webmga/frmMain.aspx?id=sb1007&stab=01&pid=billpage&tab=subject3&ys=2016RS.

6 The text of Oregon HB 2960 is available at: https://olis.leg.state.or.us/liz/2015R1/Measures/Overview/HB2960. Some additional details about employer responsibilities are available at: http://www.oregon.gov/retire/Pages/Employers.aspx.

7 The text of Massachusetts HB 3754 is available at: https://malegislature.gov/Bills/187/House/H3754.

8 Lily Lynch, Treasurer Grossman Announces *Major Step Forward in Creation of Nonprofit Retirement Plan*, Mass. Nonprofit Network (June 10, 2014), http://massnonprofitnet.org/blog/nonprofitretirement/.

New Jersey and Washington. Rather than implementing any specific state-sponsored plan, New Jersey and Washington enacted statutes establishing marketplaces to make retirement savings options available to the employees of small businesses. Both programs contemplate incentives to participating employers.

The Washington statute, SB 5826, took effect on July 24, 2015, and seeks to connect employers and employees with approved savings plans. It applies to self-employed workers, sole proprietors, and employers with less than 100 qualified employees. A director must approve a variety of private plan options to be included in the marketplace and otherwise administer the program.[9]

The New Jersey Small Business Retirement Marketplace Act, A4275, was modeled after the Washington marketplace statute. It similarly applies to individuals, partnerships, sole proprietors, and other types of employers with less than 100 qualified employees. The New Jersey law establishes the marketplace within the state's treasury department and authorizes the treasurer to design and implement the program. The treasurer is required to approve a diverse array of options, including at least two IRA plans and relevant life insurance policies.[10]

Pending Automatic Enrollment Legislation

Michigan (HB 5776), New York (AB 8332 / SB 6045), and Pennsylvania (HB 2396) currently have automatic payroll deduction legislation pending.[11] It is unclear whether these bills will advance during their current legislative sessions.

DOL Final and Proposed Rules

For many states considering these types of programs, a major concern has been the potential unintended imposition of legal duties on employers, particularly duties under ERISA. To alleviate this concern, the DOL has issued final and proposed rules to facilitate the creation of state-sponsored IRA savings programs for employees.[12]

The final rule, effective October 31, 2016, explains how states can structure their programs so that employers do not inadvertently sponsor ERISA plans. It sets out conditions on the organization of the state program and the scope of the employer's involvement. So long as the program meets those conditions, the employer should be protected by this new safe harbor provision.[13]

In particular, in order to satisfy the safe harbor, a state mandatory savings program needs to meet the following requirements:

- The program must be specifically established pursuant to state law;
- The program is implemented and administered by the state (or by a governmental agency or instrumentality of the state), which is responsible for investing funds withheld from employees' paychecks or for selecting the investment alternatives from which employees can choose;
- The state (or governmental agency or instrumentality of the state) assumes responsibility for the security of payroll deductions and employee savings made pursuant to the program;

9 The text of Washington SB 5826 is available at: http://app.leg.wa.gov/billinfo/summary.aspx?bill=5826&year=2015.

10 The text of New Jersey A4275 is available by searching at: http://www.njleg.state.nj.us/bills/BillView.asp.

11 The text of Michigan HB 5776 is available at: https://mirsnews.com/bills/details/32492?printable=1. The text of New York AB 8332 is available at: https://www.nysenate.gov/legislation/bills/2015/a8332/amendment/f. The text of Pennsylvania HB 2396 is available here: http://www.legis.state.pa.us/CFDOCS/Legis/PN/Public/btCheck.cfm?txtType=HTM&sessYr=2015&sessInd=0&billBody=H&billTyp=B&billNbr=2396&pn=4001.

12 U.S. Dep't of Labor, Employee Benefits Security Administration, News Release (Aug. 25, 2016), https://www.dol.gov/newsroom/releases/ebsa/ebsa20160825.

13 U.S. Dep't of Labor, Employee Benefits Security Administration, Savings Arrangements Established by States for Non-Governmental Employees, 29 C.F.R. Part 2510 (2016). The section specifically addressing state savings programs will appear at 29 C.F.R. § 2510.3-2(h).

- The state (or governmental agency or instrumentality of the state) adopts measures to ensure that employees are notified about their rights under the program, and creates a mechanism for enforcement of those rights;
- Employee participation in the program is voluntary;
- All rights of the individual participants in the program are enforceable only by such participant or an authorized representative, or by the state (or governmental agency or instrumentality of the state);
- Employer involvement is limited to the following:
  - Collecting employee contributions through payroll deductions and remitting them to the program;
  - Providing notice to the employees and maintaining records regarding the employer's collection and remittance of payments;
  - Providing information to the State (or governmental agency or instrumentality of the State) necessary to facilitate the program's operation; and
  - Distributing state-produce information about the program to employees and permitting the state (or governmental agency or instrumentality of the state) to publicize the program to employees.
- The employer contributes no funds to the program and provides no monetary incentive to employees to participate in the program;
- The employer's participation in the program is required by state law;
- The employer has no discretionary authority, control, or responsibility under the program; and
- The employer receives no direct or indirect consideration in the form of cash or otherwise, other than consideration received directly from the state (or governmental agency or instrumentality of the state) that does not exceed an amount that reasonably approximates the employer's (or a typical employer's) costs under the program.

In addition, the final rule provides that a state mandatory savings program will not fail to satisfy the safe harbor merely because it (1) is directed toward employers that do not offer a retirement savings vehicle to employees; (2) utilizes service or investment providers to operate and administer the program, provided that the state (or governmental agency or instrumentality of the state) retains full responsibility for the operation and administration of the program; or (3) treats employees as having automatically elected payroll deductions (or automatically elected to increase payroll deductions, if applicable) provided employees are given notice of the automatic deductions/increases in advance and are provided the opportunity to opt out of the program or select a different deduction percentage.

The proposed rule seeks to expand the new safe harbor regulation to include state political subdivisions, such as larger cities and counties, which would permit them to design and operate their own payroll deduction savings programs for private-sector employees without triggering ERISA preemption. The proposed expansion would cover subdivisions that meet three criteria. To be covered by the proposed safe harbor, the subdivision must (a) have the authority to require an employer's participation, (b) "have a population equal to or greater than the population of the least populous state," and (c) not be located in a state that already has a retirement savings program for private-sector workers.[14] The comment period on the rule has closed.

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14 U.S. Dep't of Labor, Employee Benefits Security Administration, Savings Arrangements Established by States for Non-Governmental Employees, 81 Fed. Reg. 59581 (proposed Aug. 30, 2016), https://www.federalregister.gov/documents/2016/08/30/2016-20638/savings-arrangements-established-by-state-political-subdivisions-for-non-governmental-employees.

Recommendations

Many employers—including many smaller businesses—will be affected by the trend towards expansion of retirement savings options for workers. Employers should review any existing plans in light of these developments, particularly in states with mandatory savings program statutes on the books. Employers in states requiring enrollment should consider whether to sponsor their own plans or to participate in the mandatory programs. And employers across the country may wish to explore voluntary options, including any state-promoted programs or marketplaces.