



# WRMarketplace

An AALU Washington Report



**FINANCIAL CONCEPTS INC**

A MEMBER FIRM OF M FINANCIAL GROUP

Executive Compensation ■ Succession ■ Wealth Transfer Planning

Thursday, 1 September

#WRM 16-35

The WRMarketplace is created exclusively for AALU Members by the AALU staff and Greenberg Traurig, one of the nation's leading tax and wealth management law firms. The WRMarketplace provides deep insight into trends and events impacting the use of life insurance products, including key take-aways, for AALU members, clients and advisors.

The AALU WRNewswire and WRMarketplace are published by the Association for Advanced Life Underwriting® as part of the Essential Wisdom Series, the trusted source of actionable technical and marketplace knowledge for AALU members—the **nation's most advanced life insurance professionals.**

---

## **TOPIC: State-Based Retirement Savings Arrangements Are Coming – Better Be Aware.**

**MARKET TREND:** State governments and the White House have become increasingly concerned about citizens retiring without adequate retirement savings. Accordingly, states have implemented, or are considering the implementation of, state-based retirement savings arrangements for private sector employees who do not have access to employment-based retirement plans. To support these efforts, the Department of Labor ("DOL") recently issued guidance providing competitive advantages to state retirement savings programs.

**SYNOPSIS:** A growing number of states are considering providing broader access to retirement savings programs for the private sector. The DOL has issued guidance to support these efforts, which provides that states can implement a retirement savings program that will not run into problems with ERISA.

**TAKE AWAYS:** Now that the DOL has issued guidance on the ERISA preemption issues related to state retirement programs, more states likely will enact legislation to create such programs. When consulting with employer-clients, advisors should (1) know if the employer-client is subject to any state arrangements that require employer

participation and (2) be ready to advise the employer-client on the pros and cons of establishing its own private retirement plan versus participating in the state's program.

**MAJOR REFERENCES:** DOL Final Rule 29 CFR Part 2510 "Savings Arrangements Established by States for Non-Governmental Employees;" DOL Interpretive Bulletin 2015-02.

Approximately 68 million American workers do not have access to a retirement plan through their employer. As state governments confront concerns about inadequate retirement savings by citizens and the potential stress this issue could place on state social welfare programs, many states have considered legislation or have sought ways to expand the savings options for these workers, including the implementation of state-sponsored savings plans.

## **TRENDS IN STATE-BASED RETIREMENT SAVINGS OPTIONS**

The types of retirement savings plans and alternatives considered by states fall into the following general categories: (1) supporting arrangements that require employers not offering workplace retirement plans to automatically enroll participants in payroll deduction IRAs administered by the states (i.e., auto-IRA laws), and (2) implementing state-sponsored retirement plans covered by ERISA or facilitating employer-sponsored plans covered by ERISA through state marketplaces, prototype plans, and multiple employer plans. The states that have enacted legislation to provide or facilitate the creation of retirement savings programs are California, Illinois, New Jersey, Oregon, Massachusetts, Washington, Maryland, and Connecticut.

### **AUTO-IRAs**

Payroll deduction automatic IRA programs, or "Auto-IRAs," allow employees to make contributions to a state-run IRA with automatic payroll deductions made and submitted to the state by the employer. The DOL issued final regulations providing for an advantage to state Auto-IRA programs by providing a safe harbor that can be followed for a state program to be exempt from ERISA (an outline of the safe harbor provided in the DOL regulations is attached as an Addendum). Under the DOL regulations, the employees must be given notices about the program and the opportunity to elect to have a different amount of deductions or no deductions taken out of their paychecks. The employer's involvement with an Auto-IRA is limited to ministerial functions, such as providing notices to employees, deducting and transmitting the payroll deductions to

the state IRA, and providing information to the state that is necessary for the administration of the Auto-IRA.

Also under the regulations, the state’s program can automatically enroll an employee in an IRA. However, under prior guidance discussed in the preamble to the final regulations, automatic enrollment into private IRAs would cause a payroll deduction IRA to become subject to all of ERISA’s requirements.

There are a number of other issues associated with Auto-IRAs for employees and employers, including:

POTENTIAL ISSUES WITH AUTO-IRAs	
For Employees	For Employers
<ul style="list-style-type: none"> <li>• Limited investment options may be provided under the Auto-IRA as determined by the state or the state’s designee</li> <li>• Employees’ interests in the Auto-IRA are not protected by ERISA’s fiduciary rules or remedies because the Auto-IRA is not subject to ERISA under the DOL’s regulations</li> <li>• No matching contributions because employers are not permitted to contribute to an Auto-IRA</li> </ul>	<ul style="list-style-type: none"> <li>• An increase in administrative costs and time commitment of staff to (1) process payroll deductions and employee deduction elections, (2) provide notices to employees, (3) transmit contributions, and (4) provide information to the program</li> <li>• The inability to make employer contributions into the Auto-IRA and the resultant lack of tax savings</li> <li>• The requirement to comply with a patchwork of state laws if the employer has employees in multiple states because ERISA preemption does not apply to the Auto-IRA</li> </ul>

**STATE-SPONSORED/FACILITATED RETIREMENT SAVINGS OPTIONS: INTERPRETIVE BULLETIN 2015-02**

In this Interpretive Bulletin, the DOL expressed its view that ERISA’s preemption principles leave room for states to sponsor or facilitate ERISA-based retirement savings options for private sector employees—provided the employers participate voluntarily, and the requirements, liability provisions, and remedies of ERISA fully apply to the state programs.

**Three Approaches.** The DOL describes three approaches to implementing a retirement savings program that a state can take without running afoul of ERISA’s preemption principles: (1) the “Marketplace Approach,” (2) the “Prototype Plan Approach,” and (3) the “Multiple Employer Plan (MEP) Approach.” When implementing these approaches,

a state may not establish standards inconsistent with ERISA or provide its own regulatory or judicial remedies for conducts governed exclusively by ERISA.

**Marketplace Approach.** The Marketplace Approach is reflected in the 2015 Washington State Small Business Retirement Savings Marketplace Act. The Washington law requires the state to contract with a private sector entity to establish a program that connects eligible employers with qualifying savings plans available in the private sector market. The “marketplace” will include only products that Washington State determines are suited to small employers, provide good quality, and charge low fees. Washington employers are free to use the marketplace but are not required to establish savings plans for their employees. Washington State also does not establish or sponsor any savings arrangements under the Marketplace Approach. Instead, the state sets standards for the arrangements that can be marketed through the marketplace. Under these circumstances, the marketplace itself is not an ERISA-covered plan and the arrangements made available through the marketplace may include ERISA-covered plans and other non-ERISA savings arrangements. An ERISA-covered plan established by an employer through the marketplace will be subject to ERISA’s reporting and disclosure requirements, protective standards, and remedies.

**Prototype Plan Approach.** Under the Prototype Plan Approach, employers can adopt a contributory retirement plan developed and administered by the state. Typically, a prototype plan is developed and sponsored by a bank, insurance company, or other regulated financial institution and made available to employers that are or will become their customers. A state-administered prototype plan could designate the state or a designee of the state, instead of the employer, as the plan administrator and named fiduciary. Under such an approach, the state or state designee can assume responsibility for most of the administrative and asset management functions that are typically the function of the employer or employer’s designee. The state also can designate low-cost investment options and third party administrative service providers for its prototype plans. Massachusetts is an example of a state that uses the prototype plan approach under a law that allows a nonprofit organization with fewer than 20 employees to adopt a contributory retirement plan developed and administered by the State of Massachusetts.

**MEP Approach.** The MEP Approach involves a state establishing and obtaining IRS tax qualification for a “multiple-employer” plan in which employers meeting specified eligibility criteria will be permitted to join the plan by executing a participation agreement. The state or its designee would be the plan sponsor of the MEP and the named fiduciary and plan administrator of the MEP responsible for

administering the plan, selecting service providers, communicating with employees, paying benefits, and providing other plan services. With a MEP, the state could take advantage of economies of scale to lower administrative and other costs. A state-sponsored MEP arrangement also could reduce the overall administrative costs for participating employers because the DOL would consider the arrangement as a single ERISA plan which would be required to file a single Form 5500 for the whole arrangement. The DOL would not consider each participating employer to be creating its own separate ERISA plan as it would for an employer participating in a private sector MEP.

**Advantages and Disadvantages of Approaches.** Each approach to state-run retirement arrangements comes with advantages and disadvantages, as summarized below:

STATE-RUN RETIREMENT ARRANGEMENTS		
APPROACH	ADVANTAGES	DISADVANTAGES
Marketplace	<ul style="list-style-type: none"> <li>Provides an exchange that small employers can use to find low-cost retirement plan products and services.</li> </ul>	<ul style="list-style-type: none"> <li>Plan design and investment options are limited to those authorized by the state agency to be included in the exchange.</li> <li>More suitable options may be available outside the exchange that an employer can find with the assistance of a retirement plan advisor.</li> </ul>
Prototype Plan	<ul style="list-style-type: none"> <li>Potential relief for employers from performing plan functions because the prototype plan may name the state as the investment fiduciary and plan administrator.</li> </ul>	<ul style="list-style-type: none"> <li>Plan design choices are limited to those included in the prototype plan document by the state.</li> <li>Investment options are limited to those made available by the state.</li> <li>More suitable options may be available from a financial institution or insurance company that an employer can find with the assistance of a retirement plan advisor.</li> </ul>
MEP	<ul style="list-style-type: none"> <li>An employer adopting a MEP run by the state will not be considered to have established its own retirement</li> </ul>	<ul style="list-style-type: none"> <li>May provide limited plan design choices and investment approach.</li> </ul>

	plan under ERISA.	<ul style="list-style-type: none"> <li>• More suitable plan and investment options may be available in the private sector that may outweigh the costs of maintaining a separate retirement plan.</li> </ul>
--	-------------------	---

## TAKE AWAYS

Now that the DOL has issued guidance on the ERISA preemption issues related to state retirement programs, more states likely will enact legislation to create such programs. When consulting with employer-clients, advisors should (1) know if the employer-client is subject to any state arrangements that require employer participation and (2) be ready to advise the employer-client on the pros and cons of establishing its own private retirement plan versus participating in the state’s program.

### ADDENDUM – FINAL DOL REGULATIONS ON “AUTO-IRAs”

The DOL published final regulations in August 2016 providing a safe harbor for state automatic IRA programs. On the same day, the DOL also published proposed regulations that would expand the safe harbor to local governments.

DOL Regulation 2510.3-2

The final regulations provide that a state automatic IRA program will not be subject to ERISA if the program meets the following conditions of the safe harbor:

- (1) The program is specifically established pursuant to state law;
- (2) The program is implemented and administered by the state establishing the program (or by a governmental agency or instrumentality of the state) which is responsible for investing the employee savings or for selecting investment alternatives for employees to choose;
- (3) The state (or governmental agency or instrumentality of the state) assumes responsibility for the security of payroll deductions and employee savings;
- (4) The state (or governmental agency or instrumentality of the state) adopts measures to ensure that employees are notified of their rights under the program and creates a mechanism for enforcement of those rights;

- (5) Participation in the program is voluntary for employees;
- (6) All rights of the employee, former employee, or beneficiary under the program are enforceable only by the employee, former employee, or beneficiary, an authorized representative of such a person, or by the state (or governmental agency or instrumentality of the state);
- (7) The involvement of the employer is limited to the following:
  - a. Collecting employee contributions through payroll deductions and remitting them to the program;
  - b. Providing notice to the employees and maintaining records regarding the employer's collection and remittance of payments under the program;
  - c. Providing information to the state (or governmental agency or instrumentality of the state) necessary to facilitate the operation of the program; and
  - d. Distributing program information to employees from the state (or governmental agency or instrumentality of the state) and permitting the state (or governmental agency or instrumentality of the state) to publicize the program to employees;
- (8) The employer contributes no funds to the program and provides no bonus or other monetary incentive to the employee to participate in the program;
- (9) The employer's participation in the program is required by state law;
- (10) The employer has no discretionary authority, control, or responsibility under the program; and
- (11) The employer receives no direct or indirect compensation in the form of cash or otherwise, other than consideration (including tax incentives and credits) 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) cost under the program.

Under the final regulations, a state savings plan will not fail to satisfy the provisions of the safe harbor because the program:

- (1) is directed toward those employers that do not offer some other workplace savings arrangement;
- (2) utilizes one or more service or investment providers to operate and administer the program, provided 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 in the amount or percentage of compensation, including any automatic increases, unless the employee specifically elects not to have such deductions made (or specifically elects to have deductions made in a different amount or percentage of compensation allowed by the program), provided the employee is given adequate advance notice of the right to make such elections and further provided that a state program may also satisfy the safe harbor without requiring or otherwise providing for automatic elections.

*TCO 362135028v2*

---

## **DISCLAIMER**

**This information is intended solely for information and education and is not intended for use as legal or tax advice. Reference herein to any specific tax or other planning strategy, process, product or service does not constitute promotion, endorsement or recommendation by AALU. Persons should consult with their own legal or tax advisors for specific legal or tax advice.**

WRM #16-35 was written by Greenberg Traurig, LLP

Jonathan M. Forster

Martin Kalb

Richard A. Sirius

Steven B. Lapidus

Rebecca Manicone

Counsel Emeritus

Gerald H. Sherman 1932-2012

Stuart Lewis 1945-2012