Necessary Features for DOL Regulations Regarding State Retirement Security Programs

1. Mandatory Programs (*i.e.*, automatic IRAs).

    a. Exclusion From ERISA Coverage—Expand Existing 29 C.F.R § 2510.3-2(d) with the following features:

        i. A program described in subparagraph ii will not fail to be described in 29 C.F.R § 2510.3-2(d)(1) solely because it includes one or more of the following features:

            1. One or more of the permitted alternative retirement savings vehicles is an employee benefit plan established by a governmental authority, including a State-Sponsored Plan established by a governmental authority, which may or may not include the governmental authority described in clause ii.1.

            2. Automatic enrolment, whereby employees are considered to have enrolled in the program and elected to make payroll withholding contributions at a specified rate or amount, provided that employees are given reasonable opportunities, both before and after enrolment, to opt-out of the program and to modify or cancel such payroll withholding contribution election.

            3. Automatic escalation, whereby the contribution rate of employees will be automatically increased at specified intervals and levels, provided that employees are given a reasonable opportunity before such increases take effect to elect to not have the increase apply, contribute a different amount, or cease contributions.

            4. Establishes eligibility rules for both employers and employees.

            5. Determines whether contributions shall be made to a Roth or traditional IRA or both.

            6. Provides for the investment of employee contributions, including one or more of the following: the selection, removal, and replacement of investment managers, insurers, investment products (including annuity products) or funds, provide for common investment of account balances, allows participants to choose where to invest their contributions from a menu of available options selected by the State, select a default investment for participants whom do not have an investment election in place, and arrange for the investment of the program's funds along side of the assets of a retirement plan or deferred compensation plan maintained by a governmental authority for its own employees.

            7. Offers employees investment and general financial and consumer education

            8. Permits employees and independent contractors from other jurisdictions to participate and/or establishes a program jointly with one or more other jurisdictions;

9. Allows for the rollover of accounts to or from other such programs, IRAs, or other eligible retirement plans in accordance with Section 402(c) of the Internal Revenue Code of 1986;

10. Establishes and enforces operational and disclosure rules for the program and the investment of program contributions;

11. Establishes and enforces procedures for employee claims and correcting errors or other failures to follow the program's terms.

12. Selects, retains, removes and negotiates with vendors to provide investment, trust, custody, recordkeeping, education, communication, consulting and other services with respect to the program.

13. Establishes withdrawal and distribution rules.

14. Establishes rules applicable to an employer's obligation to make payroll withholding contributions, provide employee census information reasonably necessary to allow the program to determine eligibility and process employee contributions.

15. Limits employers covered by the mandate to specific groups of employers.

16. Establishes and enforces such other rules and procedures for the operation and administration of the program as the governmental authority determines to be necessary or desirable.

17. Delegates to a board or other body the authority to establish the rules, procedures, and other determinations described in this paragraph.

ii. A program is described in this paragraph if:

1. It is established pursuant to statute or ordinance by a governmental authority, including a state.

2. It requires private sector (non-governmental) employers to make payroll deductions from their employees' wages that are remitted to individual retirement accounts, provided that employers may avoid this requirement by providing an alternative retirement savings vehicle. Such alternative retirement savings vehicle may include an employee pension benefit plan established or maintained by an employer, an automatic IRA, or some other alternative opportunity for retirement savings.

3. It permits employees to opt-out of participation or to otherwise increase or reduce the amount or percentage of their payroll deductions upon reasonable notice.

4. It includes a board, commission, or other body, or otherwise identifies individuals, with fiduciary responsibility and accountability under state or other applicable law. Such board,

commission, other body, or identified individuals shall be responsible for selecting service providers and investment alternatives, and shall otherwise have responsible for overseeing the administration of the program.

2. Permissive Program (State-Sponsored Plan)—State and Local Governmental MEPs

   a. An employee pension plan meeting the following conditions will be treated as a single multiple employer plan, notwithstanding that it includes employees of unrelated employers:

      i. The plan is established by a governmental authority pursuant to statute or ordinance.

      ii. Employer participation is voluntary.

      iii. The plan identifies one or more governing bodies (including one or more boards, commissions, or identified individuals) who serve as fiduciaries to the Plan, and who have responsibility for the selection of investment managers, consultants, service providers, etc.

   b. An employee pension plan will not fail to be considered a single multiple employer plan solely because it includes the following features:

      i. Individual employers are not considered to be fiduciaries, except to the extent they hold plan assets.

      ii. The governmental authority is not considered to be a fiduciary, nor are individual government employees or other officials, other than those identified in Section 2.a.iii above.

      iii. The plan provides for automatic enrollment or automatic employee contributions, including automatic escalation, as otherwise permitted.

      iv. It is offered as an alternative to an automatic IRA arrangement as described in Section 1.

3. It is the position of the Department that legislation implementing the programs described in Sections 1 and 2 will not be preempted by ERISA or other Federal law.

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SUPPLEMENTAL COMMENT ON SB 1234

July 30, 2012

We have been asked to provide a brief response to one of the issues raised in the July 16, 2012 memorandum from Michael Hadley of Davis & Harman, LLP to the American Council of Life Insurers (the "ACLI Memo"). Specifically, this is to respond to the ACLI Memo's conclusion that the auto-enrollment feature of SB 1234 would result in ERISA coverage of the California Secure Choice Retirement Savings Program ("Program").

As stated in the ACLI Memo, the U.S. Department of Labor's ("DOL's") regulations provide that an arrangement established by an employer to deduct amounts from its employees' wages and remit them to an IRA will not be considered to create a "plan" that is covered by ERISA if:

- No contributions are made by the employer;
- Participation is completely voluntary for employees;
- The sole involvement of the employer is without endorsement to permit the sponsor to publicize the program to employees, to collect contributions through payroll deductions and to remit them to the sponsor; and
- The employer receives no consideration in the form of cash or otherwise, other than reasonable compensation for services actually rendered in connection with payroll deductions.

ACLI Memo, p. 6. The ACLI Memo goes on to state that:

> it is generally thought that the inclusion of an automatic enrollment feature results in employer involvement that exceeds that allowed under the safe harbor.

ACLI Memo, p. 7. For support, the memo cites a publication by the Advisory Council on Employee Welfare and Pension Benefit Plans ("ERISA Advisory Council" or "Council").[1] Although this statement is true as far as it goes, it does not apply to the facts of the Program.

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[1] The ERISA Advisory Council advises the Secretary of Labor and submits recommendations regarding the Secretary's functions under ERISA. The Council consists of 15 members appointed by the Secretary of Labor. ERISA Section 512, 29 U.S.C. § 1142.

The ERISA Advisory Council was considering whether a very similar exemption from ERISA for Section 403(b) plans (*i.e.*, tax sheltered annuities or "TSAs") would continue to apply if such a plan included an auto-enrollment feature. Although the Council expressed concern that inclusion of such a feature would violate the requirement that the affected employees' participation be "voluntary,[2]" it failed to note that DOL had previously ruled on exactly that issue.

In considering whether an auto-enrollment feature in a Health Savings Account ("HSA") violated the requirement that an employee's participation be "completely voluntary," DOL stated as follows:

> In the absence of an employee's affirmative consent, may an employer open [a Health Savings Account] for an employee and deposit employer funds into the HSA without violating the condition in the FAB that requires that the establishment of an HSA by an employee be "completely voluntary"?
>
> Yes. The intended purpose of the "completely voluntary" condition in FAB 2004-01 is to ensure that any contributions an employee makes to an HSA, including salary reduction amounts, will be voluntary. HSA accountholders have sole control and are exclusively responsible for expending HSA funds and generally may move the funds to another HSA or otherwise withdraw the funds. **The fact that an employer unilaterally opens an HSA for an employee** and deposits employer funds into the HSA **does not divest the HSA accountholder of this control and responsibility** and, therefore, would not give rise to an ERISA-covered plan so long as the conditions described in FAB 2004-01 are met.

DOL Field Assistance Bulletin 2006-02, Q&A 1 (emphasis added). In other words, an employer's automatic enrollment of an employee in an HSA does not make the employee's participation anything other than "completely voluntary."

Also relying on the ERISA Advisory Council's consideration of TSAs, the ACLI Memo suggests that auto-enrollment may cause a payroll deduction savings program to fail the separate requirement that an employer's "involvement" be limited to "permit[ting] the sponsor to publicize the program to employees, to collect[ing] contributions through payroll deductions and to remit[ting] them to the sponsor . . . ." ACLI Memo, p. 7. This assertion ignores the very

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[2] As stated by the ERISA Advisory Council:

> The majority of Council members concluded that automatic enrollment would require actions typically performed by a plan sponsor/fiduciary (e.g., designation of a default investment alternative), and consequently, an automatic enrollment option in the plan **may not be viewed as voluntary** even in light of the participant's right to opt out of the automatic contributions.

Current Challenges and Best Practices for ERISA Compliance for 403(b) Plan Sponsors, Report of the ERISA Advisory Council, November 9, 2011 (emphasis added).

different facts considered by the Council. A stated by the Council, "automatic enrollment would require actions typically performed by a plan sponsor/fiduciary (*e.g.*, designation of a default investment alternative) . . . ." Council Report, November 9, 2011. Under the Program, however, an employer would not be required to take any of the additional actions ordinarily required by auto-enrollment. Most notably, the specific issue raised by the Council—the designation of a default investment alternative—would not be the responsibility of the employer. Instead, the employer's role would be strictly limited to precisely that contemplated in the regulations—allowing the state or its delegate to publicize the program, collecting contributions from employees' pay, and remitting those contributions to the Program's custodian.

In short, the concerns raised in the ACLI Memo about the Program's inclusion of an auto-enrollment feature are misplaced. The weight of existing authority clearly establishes that auto-enrollment, as contemplated under the Program, would not make the Program involuntary. Nor would auto-enrollment lead to excessive employer involvement that would make the Program fall outside the regulatory ERISA exemption. Consequently, the accounts established under the Program would not be covered under ERISA.