MEMO# 30172

August 26, 2016

DOL Final Rule on ERISA Safe Harbor for State-Run Auto-IRA Programs

[30172]

August 25, 2016

TO: PENSION MEMBERS No. 24-16
BANK, TRUST AND RETIREMENT ADVISORY COMMITTEE No. 30-16 RE: DOL FINAL RULE ON ERISA SAFE HARBOR FOR STATE-RUN AUTO-IRA PROGRAMS

On August 25, 2016, the Department of Labor released a final regulation relating to state-sponsored retirement savings programs for private-sector workers. The regulation establishes a safe harbor from ERISA for state-mandated payroll-deduction IRA programs (including those with automatic enrollment). Along with the final rule, the Department published a proposed regulation that would expand the ERISA safe harbor to similar programs run by certain cities and counties.

Final Regulation

The final regulation (currently available here: https://www.dol.gov/sites/default/files/ebsa/temporary-postings/savings-arrangements-final-rule.pdf) is largely unchanged from the proposal issued in November 2015. [1] As under the proposal, conditions of the safe harbor include that:

- The program is established pursuant to state law;
- The program is 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;
- The state (or governmental agency or instrumentality) assumes responsibility for the security of payroll deductions and employee savings;
- The state (or governmental agency or instrumentality) adopts measures to ensure that employees are notified of their rights under the program, and creates a mechanism for enforcement of those rights;
- Participation in the program is voluntary for employees (which includes an opt-out arrangement);
- 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);

- 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) necessary to facilitate the operation of the program; and (D) distributing program information to employees from the state (or governmental agency or instrumentality) and permitting the state or such entity to publicize the program to employees;
- The employer contributes no funds to the program and provides no bonus or other monetary incentive to employees to participate;
- 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, other than consideration (including tax incentives and credits) received directly from the state (or governmental agency or instrumentality) that does not exceed an amount that reasonably approximates the employer’s (or a typical employer’s) costs under the program (this condition was modified slightly from the proposal).

The final regulation eliminated a condition in the proposal that would have prohibited states from imposing restrictions on employee withdrawals from their IRAs or imposing any costs or penalties on transfers or rollovers otherwise permitted under the Internal Revenue Code. In the preamble to the final rule, the Department explained that decisions as to the need for such restrictions or limitations are better left to the states rather than the Department.

State programs meeting the conditions enumerated above will not be considered “employee pension benefit plans” or “pension plans” within the meaning of ERISA section 3(2). The final rule also specifies that a state savings program will not fail to satisfy the safe harbor merely because the program (1) is directed toward those employers that do not offer some other workplace savings arrangement; (2) uses one or more service or investment providers to operate and administer the program, provided that the state (or governmental agency or instrumentality) retains full responsibility for the operation and administration of the program; or (3) uses automatic enrollment (including auto-escalation of contribution rates) as long as the employee is given adequate notice of the right to opt out or select a different contribution rate. Because the safe harbor applies solely to state-mandated programs, it would not provide authority for including an auto enrollment feature in a privately-administered non-ERISA payroll deduction IRA.

The Department declined to require as a condition of the safe harbor any additional consumer protections beyond the conditions outlined above (e.g., that the state must assume responsibility for the security of payroll deductions and employee savings, adopt measures to ensure that employees are notified of their rights under the program, and create a mechanism for enforcement of those rights).

The Department also failed to offer any expansion of its preemption analysis provided in the proposal, including any clarification on whether—in light of ERISA’s preemption of state law—employers already sponsoring retirement plans could be required to enroll employees excluded from the plan into a state-mandated program.

The Department clarified in the preamble to the final rule that the safe harbor conditions would not prevent voluntary participation in a state savings program by employers who are not subject to the state law mandate, as long as employees of that employer affirmatively opt in to the program.

The final rule is effective 60 days after publication in the Federal Register.

Proposed Rule Expanding Safe Harbor to Political Subdivisions of a State

Along with the final rule, the Department also released a proposed rule that would extend the safe harbor to political subdivisions of a state (i.e., cities and counties). (The proposal is currently available here: https://www.dol.gov/sites/default/files/ebsa/temporary-postings/savings-arrangements-proposed-rule.pdf.) The Department notes that it has received letters of interest from representatives of Philadelphia, New York City, and Seattle. The proposed rule would add the term “or qualified political subdivision” wherever the term “State” appears in the final regulation. The proposed rule also would add a new paragraph to define qualified political subdivision as “any governmental unit of a State, including a city, county, or similar governmental body” that meets three criteria:

1. The political subdivision must have the authority, implicit or explicit, under state law to require employers’ participation in the program.
2. The political subdivision must have a population equal to or greater than the population of the least populous state (including only the 50 states, excluding the District of Columbia and any U.S. territories). In the preamble, the Department cites Wyoming as the least populated state, with a population of 586,107.
3. The political subdivision cannot be located in a state that establishes a state-wide retirement savings program for private-sector employees.

Comments on the proposed rule are due within 30 days of publication in the Federal Register.

Elena Barone Chism
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endnotes

[1] For a description of the proposal, see Memorandum to Pension Members No. 34-15 [29502], dated November 18, 2015. For the Institute’s comment letter on the proposal, see Memorandum to Pension Members No. 2-16 [29661], dated January 21, 2016.