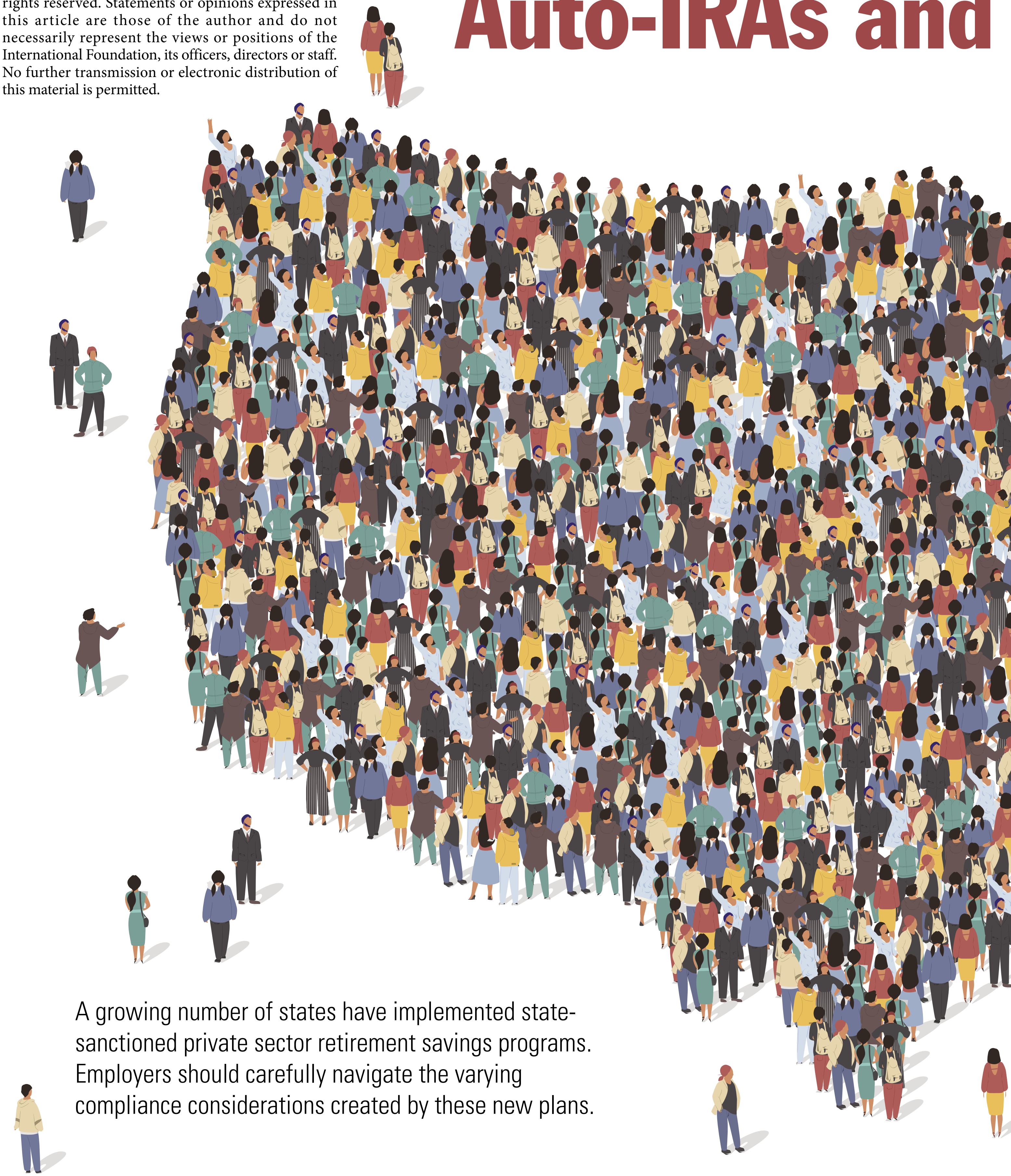
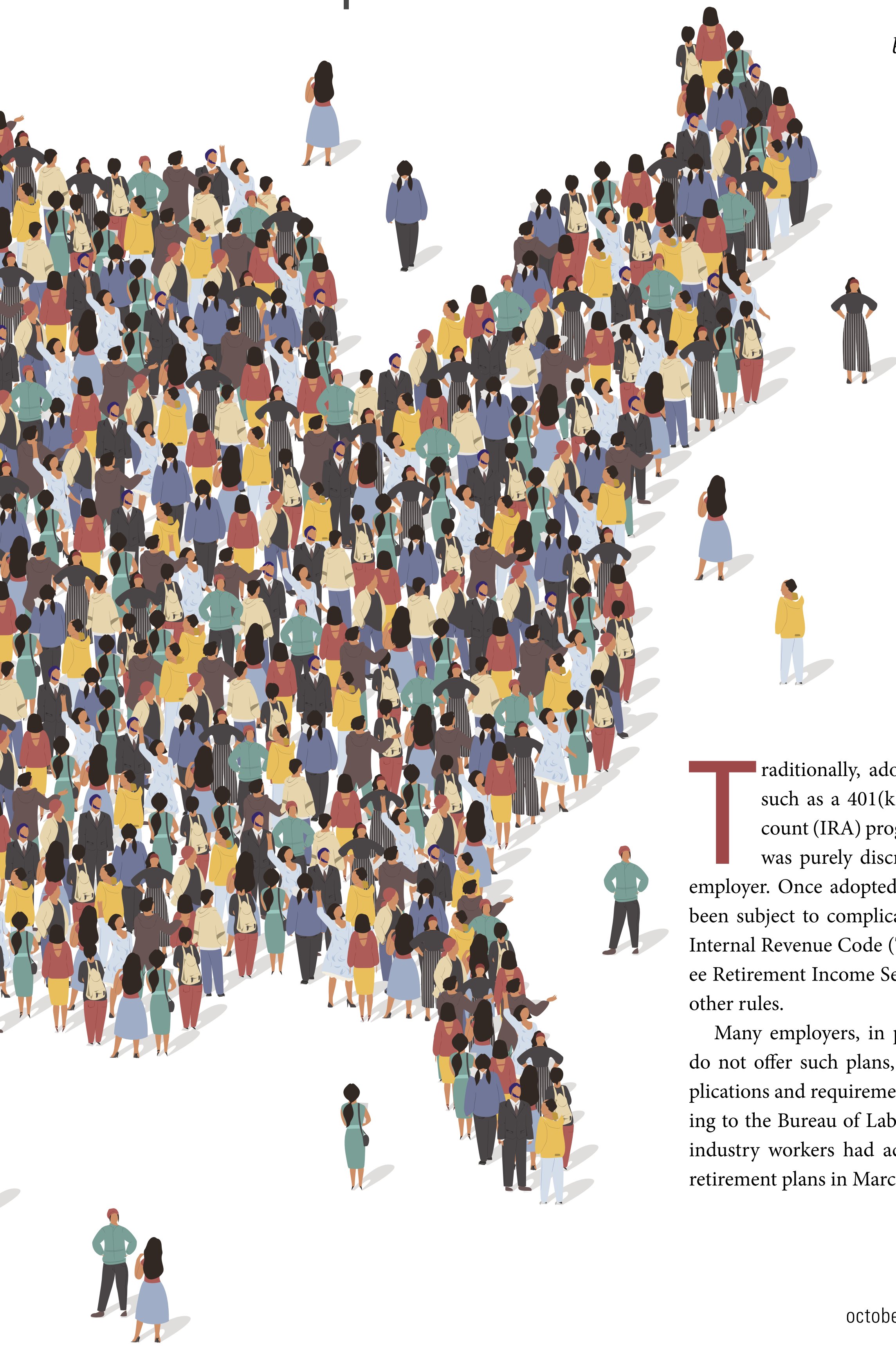
Auto-IRAs and



A growing number of states have implemented state-sanctioned private sector retirement savings programs. Employers should carefully navigate the varying compliance considerations created by these new plans.

Voluntary Marketplaces: States Respond to the Retirement Crisis

by | **Victoria H. Zerjav** and **Michael R. Romeo**



Traditionally, adoption of a retirement plan such as a 401(k), individual retirement account (IRA) program or defined benefit plan was purely discretionary on the part of an employer. Once adopted, these plans have typically been subject to complicated federal laws under the Internal Revenue Code (Tax Code) and the Employee Retirement Income Security Act (ERISA), among other rules.

Many employers, in particular small businesses, do not offer such plans, seeking to avoid the complications and requirements for compliance. According to the Bureau of Labor Statistics, 67% of private industry workers had access to employer-provided retirement plans in March 2020.

This regulatory passive time, however, may be nearing an end as states are stepping up to make available—and in some instances mandating—some form of a retirement savings program, sometimes referred to as *secure choice plans,* for the private sector (meaning nongovernmental) workforce. In 2020 alone, 17 state legislatures made a legislative proposal or directed a study, in one form or another, concerning private sector retirement savings programs.

On June 25, 2021, Maine became the latest state to enact a state-sanctioned private sector retirement savings program, following Virginia, which enacted a similar program earlier in the year. Other states, like Oklahoma, have recently introduced legislation to set up similar programs. Should the legislation pass in Oklahoma, it would become the 15th state—joining California, Colorado, Connecticut, Illinois, Maine, Maryland, Massachusetts, New Jersey, New Mexico, New York, Oregon, Vermont, Virginia and, Washington (in addition to special rules applicable in New York City and Seattle)—to make significant strides toward implementing a retirement savings program for the benefit of its residents. Oklahoma's legislation is still in its infancy, so it is unclear whether it will follow the lead of these other states.

Given the tumultuous economy of 2020 and growing concerns surrounding a potential retirement crisis, the increase in states' interest in retirement plans should come as no surprise. Massachusetts, Vermont, Washington and New Mexico have each adopted a voluntary program and, at this juncture, do not mandate employer participation. New York has also formally adopted a voluntary program, but legislation to convert the plan from a voluntary program to an auto-IRA program (and thus mandating participation) passed both houses of the Legislature on June 7, 2021. Though the amended bill still awaits the governor's signature, many anticipate that the amendment will be enacted into law. Enrollment deadlines vary by jurisdiction, but the remaining states (including Oklahoma's prospective program) either currently require participation or will require participation as their respective programs are enacted. The details and implementation deadlines for each program vary, but states generally see their programs fall into one or more of the following categories: auto-IRA programs, voluntary payroll deduction IRAs, voluntary open multiple employer plans (MEPs) and voluntary marketplace plans.

Auto-IRA Programs

Auto-IRA programs are by far the most common form of state-sanctioned retirement plan and have been implemented in nine states—California, Colorado, Connecticut, Illinois, Maine, Maryland, New Jersey, Oregon and Virginia—as well as two cities—New York City and Seattle, Washington. Although the specifics vary by state, these programs generally require participation by employers that (1) have been in business for (usually) more than two years, (2) employ a specific number of employees and (3) do not already offer qualified retirement plans. Programs in California, Illinois and Oregon are currently up and running, while a formal rollout of auto-IRA programs in Colorado, Connecticut, Maine, Maryland, New Jersey and Virginia is expected later in 2021 and 2022. As the name suggests, these are "automatic" programs that usually require covered employers to register for the program with a state-level entity charged with overseeing the program (and in some cases, "registration" may be required for the employer to confirm it is not subject to the program). In many cases, eligible employees will be automatically enrolled in participation but may opt out before deferrals begin.

At a high level, auto-IRA programs permit employees to make automatic after-tax deductions from their payroll to be deposited into an IRA. Generally, medium- to large-sized employers are required to participate in auto-IRA programs unless they already offer another qualified retirement plan option. In most cases, employers are exempt from participating in state-run auto-IRA programs if they already offer a 403(a) plan, simplified employee pension (SEP) plan, savings incentive match (SIMPLE) plan or 401(a) plan (such as a 401(k)).

In California, Illinois and Oregon, compliance deadlines were rolled out based on employer size. For example, in California, employers with more than 100 employees were required to register for the program before September 30, 2020; employers with more than 50 employees had to register before June 30, 2021; and employers with five or more employees will need to register before June 30, 2022. The programs in Illinois and Oregon both followed a similar employee-count-based rollout mechanism. In early 2021, the Illinois legislature considered legislation to expand the law from applying to businesses that employ 25 or more employees at any time throughout the previous calendar year to businesses that employ five or more employees during any quarter of the previous calendar year. The proposed amendment passed both houses of the state legislature and has been signed by the governor.

Because participation in auto-IRA programs is mandatory for at least some employers, each of the auto-IRA programs enacted to date includes penalties for noncompliance. In California, for example, an eligible employer that fails to enroll its employees in CalSavers will receive a notice of failure to comply. If noncompliance is not corrected within 90 days following notice, the employer can face penalties of $250 per eligible employee. If noncompliance extends beyond 180 days, additional penalties of $500 per eligible employee may be imposed.

Both Oregon and Illinois (as well as most other auto-IRA programs) virtually mirror California's penalty structure, calculating the penalty amount on a per-affected-employee basis. Nevertheless, in Connecticut, the legislature declined to add a penalty provision and instead created a civil cause of action for unenrolled eligible employees to bring against their employer. Pursuant to the Connecticut penalty structure, affected employees may recover costs and reasonable attorney fees if their employer fails to register eligible employees for the state-enacted program.

Currently, New York is the only state to enact a voluntary payroll deduction IRA program, but there is a twist. The New York Secure Choice Savings Program functions like the auto-IRA programs described above, but participation is entirely voluntary. If the program launches, it will be open to any employer that does not sponsor a retirement plan for its employees. Although the program was initially scheduled to launch in April 2018, rollout has since been delayed. In June 2021, a bill was introduced in the New York Senate to convert the New York Secure Choice Savings Program into an auto-IRA plan. The bill passed both houses of the legislature and awaits the governor's signature.

takeaways

- A growing number of states have passed legislation to create state-sanctioned retirement savings programs, also called *secure choice plans*. These plans seek to provide access to retirement savings programs to employees whose employers don't offer a retirement plan.
- State programs generally fall into the categories of auto-individual retirement account (IRA) programs, voluntary payroll deduction IRAs, voluntary open multiple employer plans (MEPs) and voluntary marketplace plans.
- Legal challenges have argued that these plans are preempted by the Employee Retirement Income Security Act (ERISA), but a decision in California appears to establish that ERISA does not preempt these plans as long as they are established, maintained and sponsored by states.
- Employers that do not sponsor a plan subject to ERISA should take note of the compliance issues, including registration deadlines, responsibility to provide education, and the timely handling and remittance of employee contributions.

If the bill is enacted, participation will be required for all businesses with at least ten employees in the previous calendar year. Unlike most other auto-IRA programs, the proposed program in New York currently does not include any penalty if an employer fails to enroll employees for participation (and does not include the Connecticut civil action). In addition, the proposed amendment would preclude an employer that already sponsors a qualified retirement plan from terminating its plan for purposes of participating in the New York Secure Choice Savings Program, which presumably would be less burdensome and costly to administer.

Voluntary Marketplace, Voluntary Payroll Deduction and Voluntary Open MEPs

Though New York is likely stepping back from its voluntary plan, several other states have opted to establish programs that do not mandate participation. Excluding New York, four states—Washington, New Mexico, Massachusetts and Vermont—have enacted legislation establishing voluntary retirement options for state residents. Washington, for example, has rolled out the Washington Small Business Retirement Marketplace, which is open to employers with fewer than 100 employees as well as to self-employed individuals. The Washington marketplace, which launched in March of 2018, offers a variety of plan choices for employers and individuals, including traditional and Roth IRAs, autoenrollment, safe harbor and traditional 401(k)s as well as a profit-sharing plan.

New Mexico has similarly enacted a marketplace program for employers but also offers employees the option to participate in state-run payroll deduction IRA savings programs. Any employer with a primary place of business in New Mexico is eligible to participate in the program, regardless of size. The New Mexico retirement plan marketplace, which will offer individual, MEP, 401(k) and 403(b) plans, was originally slated to launch in July of 2021 but has since been delayed. Currently, both the marketplace and IRA program are expected to launch on or before July 1, 2024.

Finally, both Massachusetts and Vermont have implemented a form of an open MEP. Both states offer 401(k)-style plans for eligible participants, with safe harbor employer matching contributions permitted in Massachusetts. Participation in the Massachusetts Defined Contribution CORE Plan is limited to nonprofits with 20 or fewer employees. Being one of the first state-run retirement programs in the country, this plan was enacted in 2012 and has remained open for enrollment since October 2017.

Employers with 50 or fewer employees may participate in Vermont's Green Mountain Secure Retirement Plan. Although participation is entirely voluntary in its current form, the enacting legislation grants the Vermont Public Retirement Plan Study Committee the authority to make a specific recommendation to increase participation in the plan if, after three years, there remains a significant number of Vermonters not covered by a retirement plan. Though no specific implementation date has been released, the Vermont Treasurer's office states that it plans to launch the program in 2021.

The marketplace and MEP state-sponsored programs appear to be designed to encourage access, and the plans in which employers participate would be subject to federal rules (applicable to the employers, and not just the employees, as in the auto-IRA programs).

Legal Challenges to State Retirement Programs

Notwithstanding the growing popularity of state-run retirement programs, challenges to these programs still exist. In 2018, a taxpayer lobbying organization filed a federal lawsuit against CalSavers, California's iteration of a private sector savings plan, alleging that the state program is preempted by the Employee Retirement Income Security Act (ERISA).[1] In March of 2020, the court dismissed the complaint filed, finding no preemption and concluding that the CalSavers plan was not an employee benefit plan under ERISA.[2] Notably, the court recognized that the CalSavers Program is a program established and administered by the state, not employers, and the program did not require employers to establish and operate their own plans.[3] Further, the court did not find that CalSavers related to an ERISA plan such that it would trigger ERISA's preemption clause.[4]

On appeal, the U.S. Court of Appeals for the Ninth Circuit affirmed the lower court's decision and permitted the CalSavers program to continue operations.[5] Critically, the Court of Appeals held that CalSavers was not preempted because the program was not established or maintained by an employer.[6] Indeed, for purposes of ERISA, the only possible employers were (1) the state of California or (2) the employers enrolling in the program.[7] In the CalSavers paradigm, California was neither acting as an employer nor acting indirectly in an employer's interest and thus was not an employer under ERISA.[8] As to the employers required to participate in the program, the court noted that it was the state, and not the employers, that has established and maintained the program.[9] Building on that analysis, the court further noted that CalSavers did not contain an impermissible reference or connection to ERISA plans, chiefly because the program does not regulate ERISA plans or the benefits provided under them.[10]

Conclusions and Considerations

Acting as the proverbial canary in a coal mine, the Ninth Circuit's CalSavers decision appears to establish a solid legal foundation for state retirement programs across the country. At a minimum, so long as states establish, maintain and sponsor their private sector retirement programs, there is a strong legal basis to conclude that ERISA does not preempt the legislation. Regardless, and even if some federal circuit courts diverge from the Ninth Circuit's holding, it's safe to assume that state-run retirement programs are here to stay unless and until Congress or the Supreme Court determines otherwise.

The programs are still relatively new, but statistics from the more established programs show that thousands of employees are participating. As of June 30, 2021, the CalSavers program held $90,114,631 in total assets, with 12,886 registered employers participating in the program. On average, eligible employees opt for a deferral rate of approximately 5%, and the average monthly contribution amount is $142.73. These metrics mirror the participation in the programs in Illinois and Oregon, with both states' programs boasting a deferral rate of around 5% (5.04% and 5.60%, respectively). Oregon led the three states in employer registrations, with 16,919 distinct employers registered for the program as of May 31, 2021.[11] Considering each of these employers would be exempt from participation if they already offered a qualified retirement plan, these state-level programs are undoubtedly providing workers with more robust retirement options than would otherwise be available.

As these programs continue to launch and new legislation is enacted in even more states, employers need to ensure that they are carefully navigating the varying compliance considerations in each jurisdiction in which they operate.

Because many of these programs are still in their infancy, the legal landscape is dynamic and rapidly evolving in light of changing federal laws and an uncertain economic outlook. The implications of the state legislation have not been given the same in-depth critiques and analysis as the more than 40-year-old ERISA and the Tax Code.

Employers that do not already sponsor a retirement plan subject to ERISA should take notice of the compliance issues presented by these programs (as well as the potentially costly penalties). In many states, registration deadlines for employers are rolled out in waves based on employee head count. While this enrollment protocol may provide hard deadlines for employers to register, the relevant compliance date may change for a given employer based on increases or decreases in the employee population.

Moreover, some states require employers to play an active role in educating eligible employees about the program features by disseminating information about a state-run plan within a specific window when an employee is hired. In many cases, eligible employers would benefit from updating their new-hire documentation in order to remain compliant in a specific jurisdiction. Further, in many jurisdictions, employers will play some role in handling and remitting employee contributions in a timely manner. Though the nuances of these compliance considerations vary by state, employers should consider consulting qualified ERISA counsel for advice.

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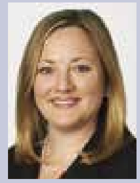

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Tracking state rules in addition to federal rules may prove to be the final straw for smaller employers, especially those with employees in multiple jurisdictions, and indeed may push those employers toward selecting the one set of rules in federal programs and instead adopting a 401(k) or IRA program. The administrative oversight required for compliance with the mandatory state requirements, particularly multiple states, may prove more burdensome than the challenges that initially deterred the establishment of a tax-qualified retirement plan, rendering compliance with the more-vetted ERISA and Tax Code rules a preferred option to the imposition of obligations under state rules, especially for those employers with operations in multiple states.

Editor's note: *Benefits Magazine* goes into production several weeks before distribution. The status of state-sanctioned retirement plans was current at the time of writing but continues to evolve.

Endnotes

1. *Howard Jarvis Taxpayers Association v. California Secure Choice Retirement Savings Program,* 443 F. Supp.3d 1152 (E.D. Ca. 2020).
2. Id.
3. Id. at 1155.
4. Id. at 1160.
5. *Howard Jarvis Taxpayers Assoc. v. California Secure Choice Retirement Savings Program,* 997 F.3d 848 (9th Cir. 2021).
6. Id. at 860.
7. Id.
8. Id.
9. Id.
10. Id. At 864.
11. Georgetown University Center for Retirement Initiatives, https://cri.georgetown.edu/states/state-data.

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