**Benefits BLUEPRINT**

a detailed analysis of emerging employee benefits developments

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# Summary: State Retirement Plan Initiatives

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This *Benefits Blueprint* describes the new Illinois Secure Choice Savings Program that will require employers with 25 or more employees in Illinois that do not offer a retirement plan to automatically enroll employees in a state-run Roth IRA. (The mandate goes into effect in two years, assuming the board created to implement the new law overcomes a number of barriers described below.) At the end, we briefly describe some of the issues this program and others like it present under the Employee Retirement Income Security Act of 1974 (ERISA).

## Illinois Secure Choice

On January 4, 2015, Illinois Governor Patrick Quinn signed the Secure Choice Savings Program Act (Act) making Illinois the second state to enact legislation aimed at ensuring private-sector employees whose employers do not offer a retirement plan have access to a state-run retirement savings arrangement through work. Quinn, a Democrat, signed the bill just days before his Republican successor, Governor Bruce Rauner, took office. In recent years, state legislatures have increasingly considered such bills, with California being the first state to enact legislation creating a state-run plan when in 2012 it passed the California Secure Choice Retirement Savings Trust Act. However, unlike the Illinois Act, the California Act requires further action from the legislature before the program may be implemented.

***Comment:*** Several states, including Colorado, Minnesota, and Oregon, have introduced (and in some cases passed) legislation requiring a study on the need for and feasibility of creating a state-run retirement arrangement for private-sector employees. States

opting to start with such a study bill generally cite the need to determine whether adding another retirement solution to the several options already available in the marketplace would be beneficial, and they generally also cite the need to understand the interaction of such state-run arrangements with federal laws.

**Mandatory Employer Participation**

The Illinois Secure Choice Savings Program (Program) requires certain employers to participate in the Program by automatically enrolling employees in a Roth IRA through the Program and arranging for employee contributions to be made through automatic payroll deduction. Employers are to distribute information packets upon the Program's launch and to future new hires in order to help communicate the availability of the Program and the option for employees to opt out. Employers must also provide an open enrollment period at least once a year to allow those employees who previously opted out of the Program an opportunity to opt in.

Employers subject to the Program's requirements are persons or entities engaged in a for-profit or not-for-profit business, industry, profession, trade, or other enterprise in Illinois that meet the following requirements:

- Have employed 25 or more employees in Illinois at all times during the previous calendar year;
- Have been in business at least two years; and
- Have not offered a qualified retirement plan (e.g., a plan qualified under Internal Revenue Code (Code) section 401(a), section 401(k), section 403(a), section 403(b), section 408(k), section 408(p), or section 457(b)) in the preceding two years.

***Comment:*** The Act later suggests that, in addition to a qualified DB or DC plan, SEP, or SIMPLE plan, an employer can opt out by offering "an automatic enrollment payroll deduction IRA."

For purposes of the Program, an employee is an individual who is at least 18 years old, is employed by an employer, and has wages allocable to Illinois under the Illinois Income Tax Act.

Employers with less than 25 employees in Illinois and/or those that have been in business for less than two years may volunteer to participate in the Program.

***Comment:*** One of the most important open questions for large employers is whether, under the Illinois Act, employers that offer a retirement plan to some but not all

employees (such as seasonal or part-time workers) would be subject to the Act's provisions. The Act's definitions seem to suggest that an employer is excluded if it offers a plan at all, but we think it was intended that uncovered *employees* (including those who will be eligible for the plan in the future) may be swept into the mandate. If so, it is not clear whether such an employer needs to have 25 uncovered employees in Illinois, or simply have 25 employees in Illinois and at least one employee uncovered.

**Employee Participation and Investment**

Employees participating in the Program (enrollees) will contribute a portion of their wages to the Illinois Secure Choice Savings Program Fund (Program Fund), which will be established as a trust and will account for each employee's Roth IRA as an individual account. The default contribution rate is three percent, but employees may opt to increase or decrease that amount, including opting out of participation entirely. There may be minimum contribution under the Program and contributions will be subject to the limits for Roth IRAs in the Code.

***Comment:*** In addition to being subject to the Roth IRA contribution limits, participating employees would also be subject to the income limits on Roth IRAs ($131,000 single and $193,000 married filing jointly for 2015). This creates a potential problem – an employee who is automatically enrolled may later determine that his or her income exceeds the threshold for Roth IRA contributions. Normally, it is the responsibility of a Roth IRA owner to inform the IRA custodian that a distribution must be made by the due date of the tax return. It is unclear what action, if any, *employers* would have to take with respect to employees who reach the income limit (or phase-out), or how the Program would account for such a situation.

Note that this same issue is presented in the Federal government's *my*RA program, which is also a Roth IRA. One difference is that the *my*RA program is voluntary and does not involve automatic enrollment, so employees contribute only with an affirmative election.

At a minimum, the Program must offer a target date fund as an investment option. The following investment options may also be made available to enrollees:

- A conservative principal protection fund;
- A growth fund;
- A secure return fund; and/or
- An annuity fund.

Although the target date fund is the initial default investment option for enrollees who do not elect another investment option, the secure return fund, if offered, may be designated by the Program as the default investment option instead.

***Comment:*** By "secure return fund," it is expected that the Illinois legislature had in mind a stable value, money market, or similar type of fund. The Act describes such fund as being one "whose primary objective is the preservation of the safety of principal and the provision of a stable and low-risk rate of return." The Program's board is permitted to insure the value of enrollees' accounts and guarantee a rate of return for the secure return fund by procuring insurance, an annuity, or another similar product.

**Program Administration**

The Illinois Act creates the Illinois Secure Choice Savings Board (Board) and the Illinois Secure Choice Administrative Fund (Administrative Fund) to provide for the administration of the Program. The Board consists of seven members and is chaired by the State Treasurer. Among other duties, the Board must:

- Design, establish, and operate the Program in accordance with retirement savings best practices and in a manner that maximizes participation, savings, and sound investment practices;
- Facilitate the Program's compliance with all applicable requirements for the Program under the Code, including tax qualification requirements;
- Provide for the de-accumulation of assets in a manner that maximizes financial security in retirement;
- Make and enter into contracts necessary for the Program's administration (e.g., retaining an investment manager);
- Maximize simplicity for employers and enrollees;
- Conduct performance reviews of any investment vendors every four years; and
- Keep annual administrative expenses at 0.75% of the total trust balance (or lower).

***Comment:*** The Illinois Program, with its mandatory employer involvement and its use of a Roth IRA under Code section 408A, is similar to some of the proposals that have been considered in other states. Other varieties of state proposals would provide for voluntary employer participation, utilize a traditional IRA, and/or operate more like a defined benefit cash balance plan. Most of these proposals include the creation of a board to administer the program.

The Board is to use the Administrative Fund to pay for the expenses it incurs in performing its duties, including start-up administrative expenses. However, the Administrative Fund was established without any funds appropriated by the state, leaving the Program's creation and implementation dependent on future state appropriations or grants and money from other sources.

***Comment:*** The Board's requirement to provide for the de-accumulation of assets "in a manner that maximizes financial security in retirement" suggests that either a lifetime income option such as an annuity or an option to take guaranteed minimum withdrawals will be made available to enrollees. The Act does not, however, appear to require that enrollees utilize such an option.

**Benefits and Program Liabilities**

An enrollee's benefit under the Program equals the balance in that individual's Program account on the date retirement benefits become payable. The only parties responsible for any financial liability with respect to the payment of benefits are those entities that the Board may have contracted with to provide insurance to protect the value of the Program. The state, on the other hand, "shall have no duty or liability to any party for the payment of any retirement savings benefits accrued" under the Program. Similarly, employers are to have no liability for an employee's decision whether to participate in the Program or for the employee's investment choices. The Act clarifies that employers "shall not be a fiduciary, or considered to be a fiduciary, over the Program."

**Employer Penalties**

An employer that is required to participate in the Program but fails to timely enroll an employee without reasonable cause (unless the employee opted out) will be required to pay a penalty of $250 for each employee for the calendar year (or partial calendar year) during which the employee was not enrolled in the Program. That penalty increases to $500 per employee for each subsequent calendar year beginning after the date on which the initial penalty was assessed.

**Barriers to Implementation**

Much of the mainstream press coverage on Illinois' passage of the Secure Choice Program made implementation of the Program sound inevitable. However, the Program must overcome several obstacles before reaching that point, if it does so at all.

*Program Funding*: As discussed above, the Act was passed without the state having appropriated any funds to pay for start-up costs. It remains to be seen what appetite the state legislature and the new Republican governor have to see this Program come to life, or whether the Program will attract sufficient grants or contributions from other sources. Under the Act, the Board may delay implementation of the Program if it fails to obtain adequate funding to implement the Program within the specified time frame. Without funding, the option to delay hardly seems like a choice.

*Department of Labor Opinion or Ruling:* The Board is required to request "an opinion or ruling" from the Department of Labor (DOL) "regarding the applicability of [ERISA] to the Program." It is unclear what the consequences would be if DOL fails to provide the requested opinion or ruling.

*Prohibitions on Implementation*: The Board is prohibited from implementing the Program if either (1) the Roth IRAs offered under the Program fail to qualify as Roth IRAs under the Code, or (2) the Program is determined to be an "employee benefit plan" under ERISA such that the state or employers become subject to liability under ERISA.

## Timing of Implementation and Employer Requirements

The Act calls for the Board to have implemented the Program and begin enrolling employees within 24 months after the effective date of the Act. Employers required to participate in the Program must set up the necessary payroll deposit arrangement to allow employees to start participating within nine months of the Board opening the Program for enrollment.

***Comment:*** The state legislature enacted the Act on December 3, 2014, and Governor Quinn signed the Act on January 4, 2015. The latter is probably the effective date, although the Act is not clear on this point. Regardless, unless adequate funding is obtained, the Board will likely be forced to utilize its option to delay the Program's implementation. Employers with Illinois employees that are not covered by a plan will need to monitor the date on which the Program is open to enrollment and then work toward meeting the initial employer requirements.

## ERISA Concerns

With certain exceptions, ERISA applies to any "employee pension benefit plan," which is defined to mean "any plan, fund, or program which was heretofore or is hereafter established or maintained by an employer or by an employee organization, or by both, to the extent that by its express terms or as a result of surrounding circumstances such plan, fund, or program (i) provides retirement income to

employees, or (ii) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond." Because the Program covers private-sector employees, it would not qualify as a "governmental plan" exempt from ERISA.

DOL regulations provide a safe harbor for certain payroll deduction arrangements in connection with IRAs. One might think that these programs fall under the safe harbor. In order to satisfy the safe harbor, however, the arrangement must be "completely voluntary" for the employee and the involvement of the employer must be extremely minimal – essentially limited to collecting contributions through payroll deductions and remitting them to the IRA. Although DOL has not addressed the issue directly, it is generally thought that the inclusion of an automatic enrollment feature results in employer involvement in excess of that allowed under the safe harbor. (Thus, for example, it is generally thought that a 403(b) plan with automatic enrollment would not be eligible for a similar safe harbor for 403(b) plans.)

DOL hinted as much in a recent Information Letter it issued in December 2014 with respect to the federal *my*RA program. The letter concluded that, as a governmental program, *my*RA is not subject to ERISA because DOL did not believe that Congress would have intended to subject that program "to the extensive reporting, disclosure, fiduciary duty, or other requirements of ERISA, which were established to ensure against the possibility that employees' expectation of a promised benefit would be defeated through poor management by the plan sponsor and other plan fiduciaries." The Information Letter specifically mentioned that the Treasury Department does not currently expect to use automatic enrollment and that *my*RA is completely voluntary.

More recently, DOL's Fiscal Year 2016 budget request includes a request for $6.5 million of additional funding to help states "pilot" these programs. The budget documents do not provide much detail, but appear to acknowledge "concerns about potential conflicts with the Federal law." The DOL also indicates that it will seek "waiver authority" to help states pilot these programs. This budget item discussion implies DOL has concluded that these state programs *are* subject to ERISA.

Assuming the Illinois Program, and others like it, are subject to ERISA, the natural question is whether the mandate on employers is preempted. ERISA preempts any state law that "relate[s] to" any employee benefit plan. It is well known that the preemption provision was included in ERISA by Congress to prevent conflicting or inconsistent state regulation of employee benefit plans. If these state-run plans continue to proliferate, they could impose different obligations on employers with employees in multiple states.