The State of State-Run Savings Programs

A Practical Guidance® Article by Carol I. Buckmann, Cohen & Buckmann, P.C.

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Can the average American worker afford to retire? Much has been written about the retirement savings gap-that is, the difference between projected account balances and the income employees will actually need in retirement. Yet federal law makes plan adoption voluntary, and a recent Congressional Research Service Report on state-administered retirement programs indicates that 32% of private sector workers are not covered by an employer-sponsored retirement plan. The senators who just introduced the Starter-K Act of 2022 (S.3955) report that less than 50% of businesses with fewer than 50 employees currently maintain retirement plans. Led by the State of California, some states and cities have attempted to narrow the savings gap by passing legislation creating state-run retirement programs. The list now includes Illinois, Oregon, Virginia, Maryland, New York, New Jersey and Connecticut. New York City and Seattle have also enacted programs, although following the passage of an auto-IRA law by New York State, the status of the New York City program is unclear.

Participation in mandatory programs, called auto-IRA programs. is required for employers who do not sponsor their own 401(k) or 403(b) plans. Some plans, such as California's Secure Choice program, also known as Cal Savers, even allow employees to enroll on their own. However, legal uncertainties and the COVID pandemic have delayed implementation of these and additional state programs. As a result of recent Supreme Court action, that may change, and more states may be implementing state-run savings programs.

The Typical Auto-IRA Program.

Although varying in detail, mandatory programs follow a common pattern. The programs cover employers who have a minimum number of employees working in-state. In some states, such as New York, the employer is also required to have been in business for a minimum number of years. The default contribution is a ROTH IRA contribution, which may be 3% of pay, although employees can opt out or elect a different contribution percentage. The employer is required to register or claim an exemption, and, if registered, to forward employee contributions to the state and distribute election forms and required disclosures. Many programs impose monetary penalties on employers who fail to register, and California has actually begun to impose these penalties on noncompliant employers. The state boards appointed to administer the programs arrange for professional investment of the contributions, and employers are not responsible for general administration or investment of the IRAs.

The Preemption Issue

The Employee Retirement Income Security Act (ERISA) was enacted in 1974 to impose federal standards on employee benefit plans. Section 514 of ERISA provides that ERISA preempts state laws that "relate to" employee benefit plans. Unlike some other federal laws, ERISA does not act as a baseline or permit states to enact their own stricter requirements. In fact, one of the purposes of preemption was to prevent employers with multi-state operations from having to comply with a patchwork of requirements that varied from state to state.

A threshold question in determining whether ERISA applies to an arrangement is whether there is an "employee benefit plan." If there is no plan, ERISA cannot apply, and preemption claims are moot. Although the Obama administration tried unsuccessfully to exempt the California law and similar programs from ERISA by regulation, a 1975 regulation issued by the Department of Labor remains the standard for determining whether state programs create employee benefit plans. See 29 C.F.R. Section 2510.3-2(d). This regulation establishes a safe harbor for payroll programs and provides that an employer does not create a plan if employee participation is completely voluntary and the employer's sole involvement is to allow a vendor to publicize the program without endorsement, collect the contributions and transmit them to the vendor. No employer contributions are permitted.

Howard Jarvis Taxpayers' Ass'n v. California Secure Choice Retirement Savings Program

California's law was challenged in federal court on preemption grounds but was upheld by the Court of Appeals for the 9th Circuit in *Howard Jarvis Taxpayers' Ass'n v. California Secure Choice Retirement Savings Program*, No. 20-15591, May 6, 2021. In March, the Supreme Court refused to hear an appeal from *Jarvis* (No. 21-558, cert. denied, March 22, 2022). The 9th Circuit decision found that the Cal Savers' Program was not preempted because it did not create an ERISA plan or relate to an employee benefit plan for the following reasons:

- The program was established and maintained by the state of California, not the participating employers
- Employers have no control over the program and no discretionary administrative duties. A system of administration was determined to be necessary in order for an arrangement to be subject to ERISA in the Supreme Court's decision in Halifax Packing Company v. Coyne, 482 U.S. 1 (1987), and the court ruled in Jarvis that the employer responsibilities under Cal Savers were merely ministerial.
- California is not acting in the interest of the employers
- The program does not interfere with ERISA's core purposes

The *Jarvis* decision cites several other Supreme Court decisions and its prior decision in Golden Gate Restaurant Association v. City and County of San Francisco, 546 F.3d 639 (9th Cir. 2008), in which it determined that a city run health plan to which employers were required to contribute if they didn't contribute to their own employee health plan was not preempted by ERISA.

No other federal court has addressed whether state auto-IRA programs are preempted, although the ERISA Industry Committee (ERIC) sued the Board running Oregon Saves challenging the program. Subsequently, ERIC secured exemptions for its members from the program and from the Illinois Secure Choice Retirement Savings Program and will not be litigating those preemption claims.

While the Supreme Court's denial of review is viewed by many as a green light for these programs, if a different circuit determines that auto-IRA programs are preempted, the Supreme Court could decide to hear an appeal then to resolve a dispute between the circuits. If that happens, the Supreme Court may or may not adopt the *Jarvis* analysis. For example, in *Gobeille v. Liberty Mutual Life Ins. Company*, the Supreme Court ruled that a Vermont law requiring employers to file reports about their medical coverage with the state was preempted because it interfered with the uniform national administration of ERISA plans. More recently, though, the Court determined that a state law regulating pharmacy benefit managers was not preempted. The Court's preemption decisions have not always been easy to predict.

Drawbacks to State IRA Programs

Employers cannot provide a uniform program covering their employees if coverage and contributions vary among the states in which they have employees and some of those states have no program at all. Further, employers will need to monitor and comply with different requirements in the states that do have programs.

The annual contributions to these programs are limited to the amounts that would be permitted if the employee had gone to the local bank and opened up an IRA. For 2022, this limit is $6000 or $7000, depending on whether the employee will be 50 or older by December 31, 2022. Although the default contributions to these programs are ROTH contributions, the Internal Revenue Code places income limits on the ability to make ROTH contributions, so some employees will have to either opt out or opt into regular IRA contributions where permitted. Employees may need to figure out their status on their own. Employers are not able to supplement these contributions with a match even if they wish to do so.

Employees can't accumulate meaningful retirement savings with such limited contributions. For example, even without any employer contributions, a 401(k) plan participant under age 50 can contribute $20,500 to a 401(k) plan in 2022, and that increases to $27,000 if the participant is 50 or older on December 31. If the employer contributes, the maximum 2022 contribution limit applicable to combined employee and employer contributions is $60,000 and increases to $67,500 if the employee is 50 or older. The Internal Revenue Code establishes other arrangements with lower limits for small employers.

Employees may also be losing some of their protections in ERISA, such as specific remedies for fiduciary breach, by participating in these programs

Alternatives for Employers Subject to Auto-IRA Programs.

Two significant reasons that employers don't establish plans is lack of time to deal with complex administrative requirements and fear of being sued for fiduciary breach. However, there are alternative plan arrangements that would allow employers to outsource most of their legal responsibility while allowing higher contributions than state auto-IRA programs.

A new type of plan called a pooled employer plan (PEP) allows unrelated employers to contribute to a professionally managed 401(k) plan run by a fiduciary who assumes legal responsibility for the plan. An adopting employer is still required to prudently select and periodically monitor the PEP providers but is not responsible for day-to-day plan operations. Massachusetts has even established a PEP called the CORE Plan which it has made available to non-profits with 20 or fewer employees. Other fiduciary outsourcing options, such as delegating administrative responsibilities to a fiduciary plan administrator and selection of investments to an investment manager described in section 3(38) of ERISA, are also available.

Section 408(p) of the Internal Revenue Code permits employers with 100 or fewer employees to establish SIMPLE IRAs without assuming the fiduciary responsibilities associated with standard 401(k) and 403(b) plans. SIMPLE IRAs permit employees to make greater contributions than individual IRAs or auto-IRA programs but do not match the limit for 401(k) or 403(b) plans. For 2022, employees may contribute $14,000 to a SIMPLE IRA, or $17,000 if they reach age 50 by December 31, 2022. Employers are required to make either matching or nonelective contributions to these plans.

Possible Federal Responses

While state activity to increase retirement savings may be welcome, uniform national efforts can have greater impact. While the pension reform legislation being considered now by Congress would not require employers to adopt plans and altering the voluntary nature of benefit plans would be a major change in federal policy, at least one such bill was introduced in the past. The Automatic Retirement Plan Act of 2017 (H.R. 4523), introduced by Rep. Neal, would have required most employers to offer a retirement plan with automatic enrollment or pay an excise tax. Proposals have also been made to open up the federal Thrift Plan to non-governmental employees.

The Securing a Strong Retirement Act of 2022 (H.R. 2954), commonly known as SECURE 2.0, which was recently passed by the House and has bi-partisan support, would keep plans voluntary, but would require new 401(k) and 403(b) plans to have automatic enrollment with auto-escalation. SECURE 2.0 would, among many other changes, also increase the maximum catchup contribution for certain employees to $10,000 and make PEPs available to 403(b) plans.

Federal law also incentivizes the creation of new plans through tax credits. SECURE 2.0 would increase the new plan credit for a defined contribution plan to the lesser of the amount of the employer contribution or $1,000 per participant.

The Starter 401(k) Act would simplify the administrative complexity that may deter plan formation by establishing new safe harbors.

Congress could also support and encourage state-run savings programs. Congress could establish a statutory safe harbor for state-run programs to end the preemption cloud that may still hang over state programs in the absence of a Supreme Court decision on the issue. This safe harbor could encourage state innovation by permitting greater flexibility in designing the exempted programs. Congress could also provide funding to states that choose to offer their own programs.

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Cases

- Howard Jarvis Taxpayers Ass'n v. Cal. Secure Choice Ret. Sav. Program, 997 F.3d 848 (9th Cir. 2021).
- Gobeille v. Liberty Mut. Ins. Co., 577 U.S. 312 2016).
- Golden Gate Rest. Ass'n v. City & County of San Francisco, 546 F.3d 639, (9th Cir. 2008).

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"She understands our business, is incredibly knowledgeable, responsive and provides very practical advice." "She has great depth and breadth of knowledge." - Client Comments, Chambers & Partners USA Guide

With a career that spans nearly 40 years, Carol has become one of the foremost employee benefits and ERISA attorneys in the country. She is widely known for her in-depth understanding of issues related to ERISA, including pension plan compliance, fiduciary responsibilities and investment fund formation. Her clients – global and U.S. companies – and attorneys rely on her for advice related to complex pension law and fiduciary problems. She also is experienced at advising global employers on U.S. and cross-border employee benefit matters.

Carol writes for the firm's blog, Insights, and has contributed articles to many industry publications, including 401ktv, 401(k) Specialist, PLANSPONSOR and LEXIS Practice Advisor. In addition to opining about new developments in the benefits industry, Carol also speaks frequently at industry and client events.

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