January 19, 2016

Via E-mail: e-ORI@dol.gov
Office of Regulations and Interpretations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, DC 20210
Attn: Proposed Safe Harbor Rule RIN 1210-AB71

Re: Safe Harbor Rule for State Payroll Deduction IRA Savings Programs

Ladies and Gentlemen:

The National Conference on Public Employee Retirement Systems ("**NCPERS**") appreciates the opportunity to comment on the proposal by the Department of Labor ("**Department**") to create a safe harbor exemption from the Employee Retirement Income Security Act ("**ERISA**") for certain State payroll deduction savings programs by adding a new regulation § 2510.3-2(h) ("**Proposed Safe Harbor**").

NCPERS is the largest trade association for public sector pension funds, representing more than 500 funds throughout the United States and Canada. It is a unique non-profit network of trustees, administrators, public officials and investment professionals who collectively manage nearly $3.7 trillion in pension assets held in trust for approximately 21 million public employees and retirees — including firefighters, law enforcement officers, teachers, and other public servants. Founded in 1941, NCPERS is the principal trade association working to promote and protect pensions. Although our focus is on public sector pension stakeholders, we believe that all American workers deserve the opportunity to benefit from an employer-based retirement program. Hence we are actively involved in promoting ERISA and non-ERISA alternatives to assist private sector workers to prepare financially for retirement.

NCPERS thanks the Department for its extraordinary efforts to clarify the relationship between State payroll deduction savings programs and ERISA. These efforts will enable State-initiated employee savings programs to encourage lower income employees to save for their own retirement. We particularly applaud the Department's support for auto-enrollment with an opt-out under the Proposed Safe Harbor. Academic research, numerous participant surveys and anecdotal evidence all attest to the incredible success that automatic enrollment has had in getting non-savers to save.[1] Without this feature, we believe that State-based IRA payroll deduction programs will have significantly less impact on the growing retirement insecurity problem. While not as effective as defined benefit plans, these workplace savings programs with auto-enrollment are an important step towards retirement security.

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[1] Charcalla, Veronica and Crawford, Gary, "Overcoming Participant Inertia," Prudential 2013; Butrica, Barbara A. and Karamcheva, Nadia S., "Automatic Enrollment, Employee Compensations, and Retirement Security," Center for Retirement Research, Boston College, CRR WP 2012-25, November 2012 at http://crr.bc.edu/wp-content/uploads/2012/11/wp_2012-25-508.pdf; Thaler, Richard H. and Sunstein, Cass R., Nudge, Yale University Press (2008); Beshears, John, Choice, James. J., Laibson, David, and Madrian, Brigitte C, "The Importance of Default Options for Retirement Savings Outcomes: Evidence from the United States," pp. 59-87 in Kay, Stephen J. and Sinha, Tapen, eds, Lessons from Pension Reform in the Americas, ed. Stephen. J. Kay and Tapen Sinha, New York: Oxford University Press, 2008; Benartzi, Schlomo and Thaler, Richard, "Heuristic Biases in Retirement Savings Behavior," Journal of Economic Perspectives 21(3):81-104, 2007.

The need for action is great. A study ("**Pew Study**") issued just recently highlights that 42% of fulltime and 51% of part-time private sector employees do not have access to any type of retirement program at work. Not surprisingly, the coverage gap grows as employer size decreases: 78% of workers at "micro" employers with fewer than 10 employees and 63% of workers at small employers with 10 to 49 employees lack any retirement coverage. Similarly, individuals with the lowest wages are the most likely to be uncovered.[2]

The coverage gap is crucial because employees are significantly more likely to save for retirement if they have access to a payroll withholding program at work, especially if that program provides for automatic enrollment with an opt-out. However, as the Pew Study shows, each State's coverage gap is unique, owing to differences in industry composition, employer size, fulltime/part-time breakdown and salary scale. Thus, NCPERS strongly believes that each State should have the flexibility to craft a payroll deduction program most suited to its own workforce. We are concerned that the Proposed Safe Harbor is too restrictive and detail-driven, thus impeding a State-by-State solution, unfairly preventing lower paid and other workers from benefiting and driving up program costs for all workers.

NCPERS believes that if the Department revised the mandate condition and made certain clarifying changes to the administrative and operational provisions, the Proposed Safe Harbor would become an even stronger tool for States to partner with the private sector in promoting responsible payroll savings programs that fully safeguarded workers' interests. Our comments and suggested revisions follow.

1. §2510.3-2(h)(1)(x) Employer Mandate

Paragraph (h)(1)(X) of the Proposed Safe Harbor links a program's ability to nudge employees into saving via auto-enrollment with a requirement that their employers must be mandated to join the program; without a mandate, affected employees may contribute only if they affirmatively elect to save. A survey of enacted and proposed enabling legislation with an employer mandate shows that each of these State legislatures determined to excuse from the mandate employers considered too small or too new.[3] For example California's program would exclude employers with fewer than five employees, while in Illinois the threshold is 25. Under the Proposed Safe Harbor's current "hard mandate," employees of such micro employers and start-ups would be denied the proven benefits of payroll savings *with* automatic enrollment.

Another problem with a hard mandate is that a small employer just meeting a State's workforce minimum would be forced to shut down auto-enrollment if headcount dipped below the threshold, compelling the affected employees to re-enroll by making affirmative elections. Unfortunately, many employees switched to opt-out will likely just stop contributing. This problem will be compounded for workers employed by small businesses with a variable headcount--in some years meeting the threshold and in others dripping below the threshold. The resulting roller coaster of opt-in in one year, opt-out in another will cause unnecessary confusion, increased administrative costs and likely lead to mistakes.

Finally, it is unlikely that any State would be able to fully vet all participating employers. Some ineligible employers may inadvertently or intentionally "sneak" into the Program and auto-enroll their employees. The Proposed Safe Harbor suggests that such non-mandated employers could cause an entire program to fail the safe harbor and become an ERISA plan, with potentially disastrous consequences for the thousands of participating employers and millions of employees.

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[2] The Pew Charitable Trusts: Who's In, Who's Out (January 2016).

[3] An analysis of State initiatives to promote retirement savings is at: **http://cri.georgetown.edu.**

Thus, NCPERS strongly believes that a State program with an employer mandate also should be able to accept non-mandated employers and that their workers should be covered by the full panoply of program features, including auto enrollment and escalation. Crucially, employees will not be exposed to greater risk from employer activities if these employers voluntarily decided to join a State program with automatic saving, since the employee notice, recordkeeping, investment, distribution and other rules and safeguards will be identical between mandate and non-mandate workers.

The Supplementary Information to the Proposed Safe Harbor explains the Department's view that if any *employer's* participation is voluntary, the *employee's* auto-enrollment would not be completely voluntary. Specifically, the Department appears to be concerned that an employer which voluntarily joins a program is, in effect, *establishing and maintaining* such program and will be in a position to improperly influence employees to contribute. However, since the original payroll deduction safe harbor was promulgated by the Department in 1975, the Department always has allowed some employer activity in non-ERISA payroll deduction IRAs.[4] First, of course, the employer has to select the IRA provider[s] and allow the provider[s] to solicit its employees. The Department has gone even further, allowing an employer to periodically review each sponsor's performance, replace any underperformers and negotiate for and receive a written indemnification from each sponsor.[5] Similarly, in a payroll IRA program that was invested in an group annuity contract issued by an insurer undergoing demutualization, the Department permitted the employer, as contract holder, to vote on the plan of demutualization and elect the method for allocating the demutualization proceeds among IRA participants.[6] Thus, according to the Department's long-held position, an employer has not "established or maintained" a plan under ERISA Section 4(a) simply because it has allowed a third party to make an existing payroll deduction program available to its workers.

A survey of the case law makes it clear that a non-mandated (or no longer mandated) employer could voluntarily join a State program without implicating ERISA. The question of whether a plan is "established or maintained by an employer" is one of fact "to be answered in light of all the surrounding facts and circumstances from the point of view of a reasonable person." *Deibler v. United Food and Commercial Workers' Local Union 23*, 973 F.2d 206, 209 (3d Cir. 1992). (Courts generally do not distinguish between "establishing" a plan and "maintaining" a plan in this analysis.) The purpose of the "established or maintained" requirement is to "ascertain whether the plan is part of an employment relationship by looking at the degree of participation by the employer in the establishment or maintenance of the plan." *Peckham v. GEM State Mut. of Utah*, 964 F.2d 1043, 1049 (10th Cir. 1992).

The Supreme Court has found that a plan is not established if an employer assumes no responsibility to pay benefits on a regular basis such that there is no need for ongoing administrative practices associated with the provision of benefits. *Halifax Packing Co.*, 482 U.S. at 12. Similarly, administrative acts alone do not subject a plan to ERISA but do imply the plan's existence for the purpose of determining whether the plan is "established or maintained by an employer." A program does not become an ERISA plan simply because the employer decided to extend it to employees. *Donovan v. Dillingham*, 688 F.2d 1367, 1373 (11th Cir. 1982). Instead, a plan is established when the employer takes decisive action, for example, by financing or arranging financing to fund benefits, establishing a procedure for disbursing benefits or representing to employees that a plan exists. *Ed Miniat, Inc. v. Globe Life Ins. Group, Inc.*, 805 F.2d 732, 739 (7th Cir. 1986) (addressing whether the purchase of a retirement life reserve insurance policy constitutes the establishment of an employee benefit plan); *Donovan*, 688 F. 2d at 1373. A single act or event is not definitive. *Donovan*, 688 F. 2d at 1373.

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[4] 29 CFR § 2510.3-2(d).
[5] AO 82-27A (June 16, 1982).
[6] AO 2001-03A (Feb. 15, 2001).

It is instructive that none of the cases focusing on whether an employer's "promise" to provide benefits or other action went far enough to commit, or create an ERISA plan involve a payroll deduction IRA. This dearth of judicial authority is because of the minimal level of activity and decision making by employers in making such a program available and that the affected employees did not find themselves in need of the special protection of ERISA. Similarly, a micro or start-up employer that voluntarily joins a State savings program is a mere facilitator without discretion. Indeed, a non-mandated employer that joins an existing State-enabled program with automatic enrollment will, like its mandated brethren, have no control over program administration, investments, distribution, the contribution rules or any other term of condition. And clearly the availability for an ERISA safe harbor should, if anything, be broader for a program enabled by a State with a duty to promote public welfare.

The Department's Supplementary Information, in footnote 12, cites several cases and other materials outside of the savings plan arena for the proposition that opt-in elections are more voluntary than opt-out. We respectfully submit that these cases and materials are not completely relevant to the issue here. For example, *Doe v. Wood,* the primary cased cited in the Supplementary Information, ruled that a school district that enrolled grade school children in a single-sex school unless their parents affirmatively elected to place their children in coeducational classes violated the U.S. Department of Education regulations that the choice of single sex classes must be completely voluntary. However, in *Wood* the week before public school was to begin parents were given a poorly worded notice of their rights to elect coeducational school, and by the time notice went out many children already had selected after school activities and team sports. Besides the many obvious distinctions between a child's education and an employee's retirement savings, in *Wood*, once the school year began, it would be emotionally and practically difficult for a child to switch schools. With automatic enrollment in a State program, the employee may stop contributing at any time simply by calling toll-free, visiting a website or mailing a paper form to the recordkeeper. Indeed, if the employee wishes a complete "do-over," he or she could easily withdraw the funds from the IRA, generally without penalty or tax consequences. We believe that the other cases and materials cited by the Department are similarly distinguishable.

Legally, an opt-out mechanism is as much a completely voluntary election as an opt-in. While new to IRA-based programs, an opt-out approach is simply a tool to help individuals save; it does not change the dynamic that such saving is voluntary. A contributory savings program must either be opt-in or opt-out. In Bulletin 99-1, the Department noted the large number of workers, especially at smaller employers, without access to any retirement plan and America's low savings rate. Sadly, the problem has gotten significantly worse over the ensuing 15 plus years and is reaching crisis proportions.[7] The Proposed Safe Harbor recognizes the proven technique of auto-enrollment to nudge employees to voluntarily save for retirement. This clear advantage should not be denied to employees who happen to work for micro and start-up businesses that fall below a State's mandate but wish to join/remain in a program, especially as these individuals will be free to opt-out before enrollment or at any time thereafter.

Therefore, NCPERS requests that this condition be softened to prevent the problems described above that "mandate States" will face, namely the exclusion of workers of micro or other employers not covered by the mandate and the consequences of a program's inadvertent coverage of non-mandated employers. Thus, NCPERS requests the Department to add the following new paragraph (h)(2)(iv):

[7] Interpretive Bulletin 99-1 (29 CFR 2509.99-1

(iv) Allows employees to participate in a State savings program, including the automatic election and increase provisions in (iii) above, even if such employees' employer is not required to participate under paragraph (h)(1)(x), or the employer is required to participate, but the employees are not affected by such requirement. This paragraph (iv) shall only apply to a State savings program under which State law requires employers meeting specified conditions, such as minimum number of employees, doing business in the State or years in existence, participate in the program.

2. §2510.3-2(h)(1)(x) Established pursuant to State Law.

Paragraph (h)(1)(i) of the proposed Safe Harbor requires that "the program is established pursuant to State law." We believe State legislatures, will delegate to a State-appointed board or similar body the authority to determine a number of program features. Such features might include the default contribution rate, when auto-escalation will kick in, investment of program funds (including whether participants will be allowed to choose between a menu of board-selected funds), and withdrawal and distribution rules. For example, California is expected to delegate the authority to set and modify many program terms as well numerous administrative decisions to the board. It would be extremely disruptive and costly if these decisions also had to be approved by the State legislature.

Thus, the Proposed Safe Harbor should be clarified to provide that if the program is established under State legislation, even if it delegates authority to a board or other State-appointed person, the program would be considered to be established pursuant to state law. (We suggest language to accomplish this at the end of comment 3 below.)

Paragraph (h)(2)(iii) suggests that a program's auto-contribution and escalation features should be "specified under State law." As discussed in the preceding paragraph, a State legislature should be able to delegate authority to set or change the contribution/escalation rates to an appointed board or other person.

Therefore, this paragraph should be changed to delete the word "specified."

3. §2510.3-2(h)(1)(ii) & (2)(ii) Program Administration.

The Proposed Safe Harbor could be read to limit a State's ability to delegate various duties to money managers, recordkeepers and other third parties. Thus, paragraph (ii) provides "[t]he program is administered by the State ...or by a governmental agency or instrumentality of the State, which is responsible for investing employee savings or for selecting investment alternatives for employees to choose." Similarly, paragraph (h)(2)(ii) permits a program to use service providers, if the State or designated governmental agency or instrumentality "retains full responsibility for the operation and administration of the program."

NCPERS understands that most, if not all, State programs, will be operated by third parties that will handle recordkeeping, reporting, communication and distribution functions. Further, program moneys will be invested by professional managers (either directly or through designated investment vehicles) selected by a board or committee with the advice of expert consultants. The appointing State entity will have a duty to select, monitor and replace vendors in accordance with State law, but these third parties should be responsible for their own actions and contractually assumed duties. The Safe Harbor should clearly reflect this outsourcing approach. Also, the singling out of investments in paragraph (h)(1)(ii) is confusing.

Thus, the NCPERS recommends that these two paragraphs be revised as follows:

(h)(1)(ii) "The program is administered by the State establishing the program, or by a governmental agency or instrumentality of such State or by a committee, board or other person selected pursuant to State law."

(h)(2)(ii) "A program that utilizes one or more service or investment providers and consultants to operate and administer the program, including the investment of program funds, will not fail to meet the requirements of this section, provided that the State or other person described in paragraph (h)(1)(ii) of this section, is responsible for selecting, monitoring and, as such person deems appropriate, replacement of the providers or consultants."

4. §2510.3-2(h)(1)(iii) & (iv) Enforcement of employee rights.

Two requirements in the Proposed Safe Harbor are confusing and duplicative of existing State regulation. First, paragraph (h)(1)(iii) requires that "[t]he State assumes responsibility for the security of payroll deductions and employee savings." We believe this language simply is intended to protect employees from employer fraud or error in timely transmission of withholdings to the program custodian and investment in the proper vehicle. However, the employer and its payroll vendor, and not the State, will be *responsible* for the actual withholding and delivery of funds. Of course, as with all payroll and investment issues, if the employer/vendor acts improperly, the State will use its police powers to enforce its laws, correct such improper activity and punish wrongdoers.

Thus, NCPERS urges the Department to eliminate (iii) in its entirety from the Proposed Safe Harbor.

In a similar vein, paragraph (h)(1)(iv) requires that that "[t]he State adopt measures to ensure that employees are notified of their rights and creates a mechanism for the enforcement of those rights." The word "ensure" is misplaced; we believe that the Department simply intends that the State's rules require that the appropriate party (most likely the program administrator) provide employees with the notice. Furthermore, each state each has "wage-hour" laws and an enforcement system to protect employees against employer's failure to properly withhold from their paychecks and apply those withholdings as required by law. Thus, the Safe Harbor should not require that a State add special enforcement mechanisms or additional security mechanism to protect workers enrolled in its payroll deduction savings program, to the extent that the State determines that laws and regulations already on the books are available. Similarly, States already have regulatory and judicial systems in place to allow employees to enforce their program rights and should not be required to create a new and duplicative enforcement regime. While States likely will develop an ERISA-like internal program claim system, NCPERS does believe that the Proposed Safe Harbor should not require a State to adopt such a system, but rather leave it to the individual States to decide the best approach.

NCPERS recommends that the Department rewrite the requirement as: *"[t]he State shall adopt measures to cause employees to be notified of their rights under the program. Such rights may include an internal claims and dispute resolution process."*

5. §2510.3-2(h)(1)(vi) Withdrawals

Paragraph (vi) of the Proposed Safe Harbor would not permit a program to impose any "restriction," "cost" or "penalty" on an employee's ability to withdraw, transfer or rollover his or her IRA. However, such limitations could limit a program's investment flexibility (e.g., a stable value funds with an "equity wash" or an insurance company annuity payable only on death, disability or a stated age) and ability to impose cost-saving administrative restrictions (e.g., withdrawals, transfers or rollovers limited to once a quarter). Further, States may wish to confront the serious problem of "leakage"--employees using their IRAs for discretionary purchases, vacations, etc. by imposing a hardship standard on withdrawals before a certain age.[8] Of course, the participating employers would have no involvement in hardship withdrawals.

[8] The Internal Revenue Code IRA rules allow the use of a hardship restriction.

Thus, NCPERS recommends that the paragraph (vi) be deleted. If the Department determines that a hardship withdrawal limit is not appropriate, then we recommends that paragraph (vi) be revised as follows:

(vi) The program does not require that an employee or beneficiary retain any portion of contributions or earnings in his or her IRA and does not otherwise impose any restrictions on withdrawals, other than limitations on the timing and frequency of withdrawals for administrative convenience or cost savings or impose any cost or penalty on transfers or rollovers permitted under the Internal Revenue Code, provided that a program may impose investment-based restrictions, costs or penalties (e.g., an equity wash; market value adjustment or distribution rules imposed in an insurance company annuity contract).

Conclusion

NCPERS thanks the Department for promulgating the proposed rules and strongly supports the Department's goal of allowing States to establish payroll deduction IRA savings programs that are exempt from ERISA regulations. The exemption will enable States to partner with private sector investment managers, recordkeepers, custodians and other third parties to create simple, low-cost programs and enable lower income workers to save for retirement. For the reasons discussed above, we believe that softening the mandate condition and making certain other simplifications and clarifications to the Proposed Safe Harbor will extend the benefits of these IRA savings programs to more lower-income employees and reduce program administrative costs without sacrificing any worker safeguards.

Respectfully submitted,

Hank Kim, Esq.
Executive Director & Counsel