The SPARK Institute, Inc.
SHAPING AMERICA'S RETIREMENT

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Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: State Savings Arrangements Safe Harbor
Room N-5655
U.S. Department of Labor
200 Constitution Avenue N.W.
Washington, DC 20210

Re: <u>Comments on Recent Guidance on State Retirement Savings Programs for Private Sector Employees (RIN 1210-AB71)</u>

Dear Sir or Madam:

The SPARK Institute, Inc.[1] is pleased to submit this comment letter to assist the Department of Labor ("Department") on its proposed regulation and related guidance on state retirement savings programs for private sector employees.

Background

One of the most critical missions of the SPARK Institute is promoting the important and substantial benefits of employer-sponsored retirement plans, which we believe have provided and continue to provide a significant contribution to the financial security of Americans saving for retirement. For example, we have supported efforts to expand coverage so that more workers have access to, and utilize, employer-sponsored savings vehicles like 401(k), 403(b), and 457(b) plans. In 2010, we developed a conceptual model for a "Universal Small Employer Retirement Savings Program," USERP, a simplified and standardized savings plan for small employers that have been unwilling to adopt one of the current employer-sponsored plans that are available. Many of the concepts in the USERP – simplified plan administration, automatic enrollment, and limited employer contributions – are shared by many of the proposals featured in Congress, in the states, and elsewhere. We also have advocated for *simplifying* the rules that govern plans to make it easier and less expensive for a small employer to offer a plan. We have been consistently clear that we believe that employment-based retirement savings plans are a vital part

[1] The SPARK Institute represents the interests of a broad-based cross section of retirement plan service providers and investment managers, including banks, mutual fund companies, insurance companies, third-party administrators, trade clearing firms, and benefits consultants. Collectively, our members serve approximately 70 million employer-sponsored plan participants.

of any effort to help Americans enjoy a successful retirement, and thus the first test for any public policy requires it to do no harm to these employer-sponsored plans, which are governed by ERISA and supported by tax incentives in the Internal Revenue Code.

For the past few years, states across the country have taken unprecedented actions to promote retirement savings by proposing, studying, and seeking to create new retirement programs for private sector employees. Although these programs may offer one potential way to increase retirement savings for some Americans, they also raise significant legal and policy questions that must be addressed before states can proceed with their efforts. From a legal perspective, it remains unclear how these programs will interact with federal laws. Most notably, ERISA's broad preemption provisions make it unclear whether these programs, as envisioned, are permitted under federal law; and even if ERISA does not preempt these initiatives, it remains unclear how ERISA's complex layers will work in harmony with them in the absence of a financially responsible plan sponsor.

In an effort to relieve some of these uncertainties and help provide guidance for state-based retirement programs that would cover private sector workers, the Department of Labor recently issued two related pieces of guidance. First, Interpretive Bulletin 2015-02 summarized the Department's view that ERISA "leaves room for states to sponsor or ***facilitate*** ERISA-based retirement savings options for private sector employees" (emphasis added) and provided guidance on how states can design such programs to operate outside the ERISA requirements that would otherwise apply to plans established for private sector employees. Second, the Department issued proposed regulations that would create an ERISA safe harbor for state programs that require employers to automatically contribute a portion of their employees' wages to a state-created IRA, unless the employees affirmatively elect otherwise. Without this proposed safe harbor, ERISA's existing guidance would pose a significant barrier to state programs that require automatic enrollment.

The SPARK Institute appreciates the Department's recent efforts to address the above-described uncertainties. And we share the same goal – increased retirement plan coverage. However, we are concerned that many of the state initiatives that have been recently created or are under active development, together with the Department's accompanying guidance, have the potential to limit or inhibit overall retirement savings without further consideration. We also believe it critical that we actively discourage, where possible, employers dropping their plans. Through our comments below, the SPARK Institute seeks to support the activities that we believe will increase retirement savings for all employees and to highlight the areas in which we are concerned that recent state and federal activity could undermine the existing system.

Discussion and Recommendations

A. Comments on Interpretive Bulletin 2015-02

1. <u>The value of the marketplace approach</u>

SPARK supports the Department's guidance clearing a path for state-based retirement programs that connect eligible employers with existing private sector retirement savings vehicles – also known as the "marketplace approach." Under such a program, employers would be free to adopt the retirement savings approach, including an employer-sponsored ERISA-covered plan, which best meets their needs and the needs of their employees. We believe that these programs should receive further support from the states and the Department because they rely on private retirement savings arrangements that have already proven successful in helping Americans prepare for retirement, encourage employers to support their employees' retirement goals, and provide employers with flexibility. The marketplace approach harnesses the existing system and puts it to work for retirement savers by allowing employers of all sizes to understand and appreciate the many options and benefits created by offering their employees a plan.

Among other advantages, the marketplace approach, like the program adopted in Washington State (and moving forward in New Jersey), works well with an Obama Administration initiative *that is already in place* – the federal *my*RA program.[2] In fact, we are somewhat surprised that the Department has moved forward with the proposed regulation promoting state-based IRA approaches while the *my*RA program – designed to fill in precisely the same gaps in coverage – has yet to be tested or given a chance to penetrate and increase savings. As a single, voluntary, federal program, *my*RA does not raise the same difficult issues and questions created by a patchwork of state approaches, which ERISA attempts to prevent. At the same time, *my*RA immediately offers starter retirement savings accounts to employees who might otherwise not have access to a retirement savings vehicle. The *my*RA was designed to complement, not supplant, the current system. We think the Department, before finalizing the proposed regulation, should carefully consider whether *my*RA should be given more time to meet its goals. During that time, the marketplace approach should be encouraged. It may also be helpful for the Department to consider ways that its proposed regulations could be amended to promote or support the *my*RA.

2. <u>Open MEPs should be extended to privately sponsored plans</u>

The SPARK Institute believes that we should make it easier – not harder – for a small employer to offer a plan. One important way to make it easier to offer a plan is to reduce costs through economies of scale. A successful design used by many employers – and serviced by SPARK Institute members – is the multiple employer plan ("MEP"), in which unaffiliated employers join a single plan that uses one trust, files one Form 5500, and has a single plan document. Growth in MEPs has been stymied, however, by the Department's position, despite

[2] The Washington Small Business Retirement Marketplace specifically provides for promotion of *my*RA accounts.

never having issued proposed regulations under ERISA section 3(5), that only employers sharing an employment-based common nexus or other organizational relationship may participate in a single plan for ERISA purposes.

For this reason, it is troubling that the Department, without notice or comment, has concluded that *states*, and only states, may offer open MEPs. Interpretive Bulletin 2015-02 indicates that the states are permitted to establish a single plan that covers employees from several unrelated employers because states have "a unique representational interest in the health and welfare of [their] citizens. . . " The Interpretive Bulletin then suggests that this "unique nexus" allows states to establish open MEPs but they are not permitted elsewhere because other "business enterprises" are to be distinguished.

We simply disagree that this conclusion is supported by ERISA or good public policy and encourage the Department to reconsider this position. The Department should develop guidance that would permit unrelated employers to participate in an open MEP that is not established by the state. Such guidance would significantly help private sector employees save for retirement because it would encourage employers to participate in voluntary employer-supported arrangements and allow employees to reap the benefits created by such arrangements, including reduced administrative costs and increased competition among providers.[3] We appreciate that the Department has historical concerns regarding multiple employer welfare arrangements ("MEWAs"). But we think an open MEP for a *defined contribution retirement plan* does not present any of the issues associated with MEWAs that may not have sufficient funds to meet benefit claims. In fact, the only difference between a defined contribution MEP and individual plans using an identical prototype plan document and trust agreement is the added expense of separate documents, separate administration, and separate disclosure.

Finally, in recognition of the fact that private open MEPs could raise concerns regarding oversight, we would be supportive of reasonable additional requirements, like additional Form 5500 reporting requirements for open MEPs. Any additional requirements, however, should also apply to open MEPs created by states in order to avoid an un-level playing field between the private and state-created open MEPs.

B. Comments on Proposed Regulation

1. <u>DOL should encourage an efficient and uniform administration of employee benefits</u>

For more than 40 years, ERISA's broad preemption of state laws that would otherwise impact the administration of employee benefits has promoted private retirement savings by smoothing the administration of benefits across state lines. In adopting such a sweeping

[3] We also encourage the Department to work with the Treasury Department as it develops guidance to address the so-called "one bad apple" rule for MEPs, in which a single qualification error by one employer potentially disqualifies the entire plan.

regulatory scheme, Congress recognized the problems that could result from a "patchwork"[4] regulation of employee benefits and sought to "eliminat[e] the threat of conflicting and inconsistent state and local regulation."[5] Unfortunately, the decentralized nature of recent state retirement initiatives threatens to disrupt many of the benefits resulting from this uniform and national administration of employee benefits. The following list of examples is intended to highlight some of the issues that could be created if steps are not taken to encourage greater uniformity among state programs:

- **Patchwork programs threaten efficiency.** Because states are pursuing their own retirement programs in a piecemeal fashion, these new initiatives have the potential to frustrate the efficiencies created by a national administration of employee benefits. For example, mandatory payroll deduction programs being adopted in states like California, Illinois, and Oregon, would create significant inefficiencies for employees and employers. For employees, we are concerned that these programs could scatter an individual's retirement savings across multiple accounts in different states that would be administratively difficult to maintain, especially when attempting to coordinate an investment strategy across multiple accounts. For employers, these mandatory programs would result in significant compliance costs that could discourage some multi-state employers from operating in states with such a program and encourage or require other employers to adopt multiple eligibility groups for its employees depending on state lines.

- **Duplication among state programs.** Another potential problem that will arise from the states' current patchwork development of retirement programs is the possibility for overlapping mandatory payroll deduction programs. For example, imagine the scenario in which State A requires all employers who do not offer their employees a retirement plan to automatically enroll all of their employees *working in state A* in a payroll deduction IRA sponsored by State A. At the same time, State B requires all employers who do not offer a retirement plan to their employees to automatically enroll all of their employees *residing in state B* in a payroll deduction IRA sponsored by State B. What would happen if an employee who *works in State A and resides in State B* is not offered a retirement plan through his or her employer? Would the employer be required to make automatic payroll deductions in both states? How would states coordinate to ensure that individual IRA contribution limits are not exceeded? Currently, the answers to these questions are unclear, and we note that there is no existing framework between and among states that would enable or facilitate resolution of such issues. Rather, the burden would likely fall on the individual employee to navigate among jurisdictions to ensure federal income tax limitations were met.

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[4] See *Ft. Halifax Packing Co., Inc. v. Coyne*, 482 U.S. 1, 11 (1987) (stating that "[a] patchwork scheme of regulation would introduce considerable inefficiencies in benefit program operation, which might lead those employers with existing plans to reduce benefits, and those without such plans to refrain from adopting them.").

[5] 120 Cong. Rec. 29, 197 (Aug. 20, 1974) (Statement of Rep. Dent).

Based on these potential problems and others like them, we encourage the Department to take steps that will encourage a more efficient and uniform administration of employee benefits that is streamlined and straightforward for employers and employees. In particular, we would encourage the Department's ERISA safe harbor for mandatory state IRA savings programs to *include conditions that promote simplicity, uniformity, and predictability*. Variability and complexity across states will only lead to more expensive solutions causing costs to rise and the administrative burdens for small employers to increase. Hence, simplicity, uniformity, and predictability should be a high priority in any solution.

For example, the preamble to the proposed mandatory IRA safe harbor solicits comments on whether the safe harbor should limit or require some connection between the state sponsoring the retirement program and the affected employers and employees. In response to this request, we encourage the Department to condition the mandatory IRA safe harbor in a way that ensures each employer is only required to make *one deduction and remit one amount to a single state program for each of its employees*. Any reasonable and uniform relationship between the state, the employer, and the employee would ensure such a result as long as it becomes the exclusive relationship for meeting the federal safe harbor. Such a requirement would not only prevent duplicative payroll deduction programs, but also allow multi-state employers to play by a single set of rules when designing their compliance and payroll systems. In the absence of such uniformity, employees could be simultaneously subject to multiple programs and employers could be forced to review every state's retirement program requirements to develop unique compliance and payroll systems that meet each state's requirements.

2. <u>The Department should not facilitate mandatory state retirement programs that require participation by employers who offer their employees retirement plans that meet ERISA's participation standards.</u>

Section 2510.3-2(h)(2)(i) of the proposed safe harbor states that "[a] state savings program will not fail to satisfy the provisions of [the safe harbor] merely because the program is directed towards those employees who are not already eligible for some other workplace savings arrangement." We think this provision should be reconsidered because such a rule could unintentionally discourage some employers from offering an employer-sponsored program.

In particular, we are concerned that such a state program would require employers to monitor their obligations under the law on an employee-by-employee basis, rather than the employer level. This would be particularly burdensome to administer and may cause some employers to forego offering their employees a retirement plan. For example, employers would have to coordinate their compliance and payroll systems every time an employee moved in and out of plan eligibility. This administrative burden would be especially difficult with respect to part-time and seasonal workers, who may trigger an employer's responsibility to deduct and remit wages under state law, even though ERISA and the Internal Revenue Code may not require the same employees to be eligible for the employer's plan.

Further, a regulation that allows mandatory contributions to a state retirement program based on individual plan eligibility threatens the uniform administration of benefits currently protected by ERISA's strong preemption principles, as discussed earlier. Our concerns regarding this issue can be illustrated by the following example. State X's rules mandate employers to automatically enroll, in State X's IRA program, *any* employee not eligible for a plan. State Y's rules mandate employers to automatically enroll, in State Y's IRA program, any employee not eligible for a plan, unless the employee will be eligible for the plan upon reaching age 21 and one year of service. State Z's rules mandate employers to automatically enroll, in State Z's IRA program, any employee not eligible for a plan meeting certain characteristics – such as the plan is tax-advantaged or has particular features like automatic enrollment.[6] An employer with employees in State X, Y, and Z could be required *to design its plan around these disparate requirements.* And three states could turn into 50. Further, national retirement service providers like SPARK Institute members cannot offer uniform plan designs.

We are also concerned that similar administrative complexities could arise if a state program were to require employers to automatically enroll any employees not currently *participating* in an employer-sponsored retirement plan, i.e., an employee who does not elect to defer salary in a 401(k) plan. (It is not clear that the Department's safe harbor precludes such a state program.) We believe that any programs based on plan *participation* could increase administrative burdens on some employers to a level that would lead them to forego offering a retirement plan for their employees. Therefore, we encourage the Department to include a condition in the payroll deduction IRA safe harbor that would prevent employers who offer a retirement program that meets ERISA or the Code's participation and nondiscrimination standards from participating in a state savings program that requires automatic enrollment in a state IRA.

3. <u>Ensure state retirement programs do not adversely affect employer-sponsored plans</u>

The Department's first mission in providing guidance on these recent state initiatives must be to do no harm. The Department's proposed ERISA safe harbor for state-sponsored IRAs could, however, adversely impact the availability of private employer-sponsored retirement plans. In particular, we are concerned that some employers, who already offer a retirement plan or are considering a retirement plan for their employees, may be less inclined to maintain or establish their own plan if some of their employees are already required to participate in a state-created IRA. Also, as we discussed in the preceding section, if employers that already offer a retirement plan to their employees can be required to enroll their employees who are not eligible or participating in the employer's plan, the associated administrative burdens and costs created by such a regime could discourage many employers from offering a plan.

The regulatory impact analysis for the proposed IRA safe harbor discusses some of the unique benefits available to employer-sponsored retirement plans that are not available to IRAs. These benefits, among others, include employer contributions, higher annual contribution limits,

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[6] This worry is not hypothetical. State officials associated with the various programs have publicly stated that the mandate could apply to an employer that offers a plan if that plan does not cover every employee.

design flexibility, and potential employee retention benefits. To ensure that state retirement programs based on automatic payroll deduction IRAs do not inadvertently reduce the availability of employer-sponsored plans and their accompanying benefits, we encourage the Department to do the following:

- **Conduct further study to determine whether state-based payroll deduction IRA programs will adversely affect the availability of employer-sponsored retirement plans.** The Department's economic analysis on this issue amounts to the single observation that employers will find ERISA-governed programs have "advantages" and thus "it seems unlikely that state initiatives will 'crowd-out' many ERISA-covered plans." But this question is a critical one – perhaps the most critical one. The Department must understand what impact these state initiatives will have on the offering of ERISA-governed plans if the Department provides state payroll deduction IRAs with an exemption from ERISA. Will this change the competitive pressure to offer retirement plans to attract workers, which come with higher limits, fiduciary oversight, ERISA reporting and disclosure, and often employer matching or other contributions? Will lower income and part-time workers, who tend to work for smaller employers, have less access over time to the mechanisms and protections of a full 401(k), 403(b), or similar plan? What impact will these changes have on state and federal social welfare programs? Since there are no distribution restrictions on IRAs, will so-called "leakage" from the system increase as workers in state-run IRA programs access their benefits for non-retirement purposes? These questions remain unresolved and further study is necessary before the Department proceeds with the ERISA safe harbor.

- **Limit the proposed ERISA safe harbor to state programs based on IRAs.** We also strongly recommend that any ERISA safe harbor for automatic payroll deduction programs be limited, as proposed, to state plans that use an IRA structure, with the associated lower contribution limits. This condition, at least, will ensure that full qualified plans like 401(k) plans continue to offer advantages through higher contribution limits and fiduciary oversight. Some states have considered mandatory programs that go beyond IRAs. For example, the Oregon legislation creating the Oregon Retirement Savings Plan describes a "payroll deduction defined contribution plan" yet to be defined. If such a plan were in place, this could "crowd out" ERISA-governed plans and would offer no ERISA protections.

- **Promote the marketplace approach.** As discussed above, we also encourage the Department to take actions that further promote state retirement programs, like Washington State's marketplace, which works in connection with employer-sponsored programs that have already proven successful as an effective tool for increasing retirement savings.

- **Actively discourage employers from dropping ERISA-covered employer plans in favor of state-created IRAs.** We are concerned that the newly created state-based IRAs may encourage some employers to drop their existing voluntary employer-sponsored programs in favor of simply allowing their employees to be automatically enrolled in the state programs. For many, such a result would reduce the coverage of ERISA's protections and reduce access to plans that provide matching and other employer contributions. Accordingly, we encourage the Department's safe harbor to provide a mechanism that would actively discourage employers from dropping their employer-sponsored plan in favor of the state-created IRA.

4. <u>Guidance should not create an un-level playing field for the private sector</u>

SPARK and its members are also concerned that the proposed safe harbor for mandatory state-sponsored payroll deduction IRAs, as drafted, would create an un-level playing field for state-based IRAs in a way that significantly disfavors privately offered IRAs created and maintained exclusively by the private sector. Retirement investors benefit when they are presented with a range of choices for retirement services in an open marketplace that fosters private sector innovation and competition. Unfortunately, employees could face fewer choices and lose many of the benefits enjoyed by the current system because the proposed federal regulations fail to establish a level playing field for privately-created and state-created IRAs. Most notably, the proposed safe harbor will require privately created and maintained IRAs to play by one set of rules – Labor Reg. § 2510.3-2(d) and Interpretive Bulletin 99-1 – while state-created IRAs will get to play by a more advantageous set of rules. The proposed regulations create this advantage without providing any justification other than state involvement and a desire to avoid uncertainty regarding ERISA.

5. <u>Consequences for failing to meet the safe harbor's conditions</u>

Under the proposed ERISA safe harbor, mandatory state IRA programs would be exempt from ERISA as long as the safe harbor's conditions are met. These conditions, among others, require participant notifications, limit employer involvement, and prohibit employer contributions or other incentives for employees to participate in the program. The proposed regulations do not, however, make clear what the consequences would be if all of the safe harbor's conditions are not met. This is particularly germane, as many of the states considering these programs typically condition them on no potential legal or financial consequences to the sponsoring state, and in the few situations where enforcement is referenced, provide that any issues that arise simply be corrected prospectively, rather than providing participants with any apparent recourse.

For example, what would happen if an individual employer encouraged employees to participate in the state-established program (through financial incentive or otherwise) or failed to provide the requisite notices under the safe harbor? Would the entire state program or other unrelated employers be affected by the failure to satisfy the safe harbor? Would the state be subject to liability as a fiduciary of the plan? Presumably, at least the employer who caused the failure would become a fiduciary, but how could such an employer exercise fiduciary discretion over a program that is exclusively created and designed by the state?

Unfortunately, the answers to these types of questions are not clear from the proposed regulations and the unprecedented nature of these programs makes it difficult to anticipate the full range of consequences that would arise from a failure to meet the safe harbor. Accordingly, if the Department proceeds to finalize its ERISA safe harbor for mandatory state IRAs, we encourage the Department to provide guidance on the consequences of failing to meet the safe harbor.

This is not just a technical question. In light of the continual funding problems states have with their own plans for state and local employees, many have expressed concern that, without the protection of federal law, the funds in these programs could be tapped to fill state budget gaps. The proposal requires that the state "assumes responsibility for the security of payroll deductions and employee savings," but this is hardly a guarantee that a state might not see the dollars in these programs as an attractive source to address other fiscal problems. And if that occurs, while there might be noncompliance with the safe harbor, it is likely too late for the Department to do much about it.

6. Further study is required to determine the impact of state-sponsored retirement programs on the Department's proposed fiduciary rule

As the Department acknowledges in the preamble to the new proposed regulation, "the Internal Revenue Code includes prohibited transaction provisions (very similar to those in ERISA), which are primarily enforced through imposition of excise taxes against IRA fiduciaries." The Department's proposed regulation, if finalized, will essentially create a new set of IRAs. These IRAs will require education, advice, and investment management. Since IRAs are subject to the prohibited transaction rules in the Code, this means all of these new IRAs are subject to any changes in the definition of fiduciary. The Department's April 2015 fiduciary proposal does not mention or analyze the effect, if any, its proposal would have on such IRAs. It does not determine the extent to which states, or service providers hired by states, might be subject to new rules. It does not offer any particular prohibited transaction exemptions aimed at these new structures. It provides no guidance on what education or information an employer subject to the new mandate might be able to provide without tripping into fiduciary status for purposes of Code section 4975. These and other questions were simply not considered when the Department proposed and sought comments on its fiduciary proposal. Further study is required on this topic before finalizing either proposal.

7. Coordination between DOL and SEC is needed

These state-run retirement initiatives illustrate the importance of coordination between the Department and other regulators whose rules will have an impact. In this case, we believe that these state-run IRA programs could involve issues under the securities laws that have not yet been fully considered. For example, if a state offers an IRA and provides investment management, the arrangement might be subject to the Investment Company Act of 1940 or the Securities Act of 1933. (While these acts provide exemptions for certain plan structures, it is not clear the exemptions apply here.) Accordingly, we encourage the Department to coordinate with the Securities and Exchange Commission as these issues are identified, and work together on developing guidance for resolution.

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We appreciate the opportunity to comment on this important topic. If the Department has any questions or would like more information regarding this letter, please contact me or the SPARK Institute's outside counsel, Michael Hadley, Davis & Harman LLP (mlhadley@davis-harman.com or 202-347-2210).

Sincerely,

Tim Rouse
Executive Director