EVERSHEDS
SUTHERLAND

Eversheds Sutherland (US) LLP
700 Sixth Street, NW, Suite 700
Washington, DC 20001-3980

D: +1 202.383.0215
F: +1 202.637.3593

vanessascott@
eversheds-sutherland.com

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Randy Johnson
Senior Vice President
Labor, Immigration, & Employee Benefits
U.S. Chamber of Commerce
1615 H Street, NW
Washington, DC 20062

Re: State Auto-Enrollment IRA Programs and ERISA

Dear Mr. Johnson:

You have asked us to consider the features of mandated automatic-enrollment IRA programs created through State legislation ("State Auto-Enrollment IRA Programs") to determine whether the Employee Retirement Income Security Act of 1974, as amended ("ERISA") might impact the viability of these programs. This letter addresses two points: 1) whether implementing legislation for such IRA programs may be preempted by ERISA, and 2) whether State Auto-Enrollment IRA Programs are employee benefit plans subject to ERISA.

Executive Summary

- A number of States have enacted or are considering legislation that would create State-run retirement plans for private employers and, in some cases, mandate employers not otherwise providing retirement benefits to offer such plans to employees.
- State Auto-Enrollment IRA Programs appear to create employee benefit plans as defined in ERISA, potentially subjecting adopting employers to ERISA's fiduciary duty, reporting, and disclosure provisions.
- The structure of the mandated State legislative initiatives suggests that if the programs are indeed ERISA plans, the State laws are likely to be preempted by federal law, ERISA.
- One factor that both a court and the Department of Labor ("DOL") will consider is whether the programs comply with a regulatory safe harbor for payroll-deduction IRAs. It is unlikely that current proposals will qualify. Without the benefit of the safe harbor, a court will likely determine that these plans are subject to or preempted by ERISA.
- ERISA coverage and preemption would ultimately only be determined through litigation, leaving a great deal of uncertainty as to the viability of any of these programs.

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Background

In an effort to address retirement savings concerns, a number of States are considering operating retirement plans for employees of non-government employers. Five States have enacted legislation creating auto-enrollment IRA plans: California[1], Connecticut[2], Illinois[3], Maryland[4], and Oregon[5]. In addition, some States have considered State Auto-Enrollment IRA

[1] California Secure Choice Retirement Savings and Trust Act (S.B. 1234).
[2] Connecticut Retirement Security Program (Pub. Act 16-29).
[3] Illinois Secure Choice Savings Program Act, Public Act 098-1150 (2015).
[4] Maryland Small Business Retirement Savings Program and Trust (HB 1378).
[5] Retirement Savings Plan (HB 2960).

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Programs and decided not to move forward, or to move forward with an alternative retirement plan solution.[6]

All of the five State Auto-Enrollment IRA Programs addressed herein impose a mandate on employers. There are several variations on this model, but the essential structure is that any employer that employs a specified minimum number of employees (typically five) must offer the State-run retirement plan if it does not otherwise sponsor a retirement plan for its employees. While the programs are intended to be treated as a series of Individual Retirement Accounts ("IRA"s), they share many features that are typically only found in employer-sponsored retirement plans covered by ERISA:

- Each of the programs provides for auto-enrollment with an automatic deferral rate, generally 3% (which rises under some programs) unless the employee takes action to opt out of the program or select a different contribution amount.[7]

- In some of the programs, a nominal individual account would be set up for each participant, but unlike a true IRA, the participant's benefit would not be based on the actual investment performance of the account. Instead, deferrals would be pooled and invested at the direction of an investment board.[8] In those programs where the employee is permitted to direct the investment of his or her account, the State chooses the available investment options (undertaking what would typically be the employer's role in a 401(k) plan).[9]

- In each program, employee payroll contributions are transferred to the State, where the program funds may be managed by the State or the State may contract with investment providers to which it will transfer funds.

If these arrangements are indeed ERISA plans, the State laws governing them would likely be preempted, leaving employers with the costs and obligations that follow such plans.

State Laws that Relate to Employee Benefit Plans Are Preempted by ERISA.

The United States Supreme Court has explained that the purpose of ERISA is to "establish a uniform administrative scheme, which provides a set of standard procedures to guide processing of claims and disbursement of benefits."[10] ERISA's legislative history reflects that preemption was intended to eliminate the threat that employers would be subject to a multiplicity of conflicting State laws with regard to their employees.[11] It accomplishes this goal through a broad preemption clause, which provides that ERISA "shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan."[12] The term "State law" includes all laws, decisions, rules, regulations, or other State action having the effect of law.[13]

Due to concerns that ERISA would preempt laws establishing and governing State Auto-Enrollment IRA Programs, the legislation implementing all five of the enacted programs conditioned implementation on obtaining a determination that ERISA does not apply. However, the DOL does not have the authority to grant relief from coverage or preemption and only the courts can determine whether Federal law preempts an individual State law, not the State

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[6] *E.g.*, Massachusetts, Washington, New Jersey and Vermont.
[7] California and Connecticut set the rate at 3% (California authorizes the Board to adjust that rate between 2-5%). Illinois, Maryland and Oregon give discretion to the Board to set rates.
[8] Oregon and California.
[9] Connecticut, Illinois and Maryland.
[10] *Egelhoff v. Egelhoff*, 532 U.S. 141, 148 (2001).
[11] *See, e.g., Liberty Mutual Insurance Co. v. Donegan*, 746 F.3d 497, 503 (2d Cir. 2014).
[12] ERISA section 514(a)
[13] *See Ingersoll-Rand Co. v. McClendon*, 498 U.S. 133 (1990).

itself.[14] While the DOL has noted ways in which a State-run program other than a State Auto-Enrollment IRA Program might be structured to avoid preemption, it has also conceded that it does not have blanket authority to exempt a plan from ERISA coverage.[15] Accordingly, the viability of State Auto-Enrollment IRA Programs is likely to remain unsettled until fully litigated.

1. State Auto-Enrollment IRA Programs are Likely ERISA-Covered Employee Benefit Plans.

ERISA defines an employee pension benefit plan broadly as "any plan, fund, or program… established or maintained by the employer… to the extent that such plan, fund or program… provides retirement income to employees or results in the deferral of income by employees for period extending to the termination of covered employment or beyond." [16] The term "employer" means "any person acting directly as an employer *or indirectly in the interest of an employer*, in relation to an employee benefit plan." (Emphasis added.)[17] Thus, unless there is an applicable exception, a workplace program that defers compensation is subject to ERISA.

ERISA includes exceptions from coverage for certain narrow categories of plans that otherwise would meet the definition of an employee benefit plan, including "governmental plans".[18] The term "governmental plan," in pertinent part, is defined as "a plan established or maintained *for its employees* by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing." (Emphasis added.)[19] Because State Auto-Enrollment IRA Programs are not established and maintained for employees of the State, but rather impose coverage mandates on employees of private sector employees, they are not governmental plans excepted from ERISA coverage. In fact, the DOL has opined that participation by employees of private employers in a plan sponsored by a government adversely affects the plan's "governmental plan" status.[20] Absent the availability of the governmental plan exclusion, State Auto-Enrollment IRA Programs would likely be treated as a series of separate plans established by private employers for their employees.[21]

DOL regulations contain additional exceptions for arrangements that it will not treat as employee benefit plans.[22] In particular, the DOL exempts certain payroll deduction IRAs with minimal employer involvement from the definition of an employee pension benefit plan. This exception applies to an "individual retirement account described in section 408(a)" of the Internal Revenue Code (Code) or "an individual retirement annuity described in section 408(b)" of the Code provided that certain "safe harbor" conditions, described below, are met.[23]

The problem with this regulatory safe harbor is that it only applies to IRAs described in section 408(a) (IRA accounts) or 408(b) (IRA annuities) of the Code. Although the programs are intended to be structured as IRAs, the arrangements will not qualify as IRA accounts or IRA annuities under section 408(a) or 408(b) of the Code for the following reasons:

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[14] In fact, the DOL itself has noted that only a court of competent jurisdiction has the authority to determine whether State Auto IRA laws are preempted by ERISA. *See* 80 FR 72011(Nov. 18, 2015).
[15] *See* Interpretive Bulletin 2015-02 (29 CFR §2509.2015-02).
[16] ERISA section 3(2)(A).
[17] ERISA section 3(5).
[18] ERISA section 4(b)(1).
[19] ERISA section 3(32).
[20] DOL Adv. Op. 2012-01A, concluding that the State of Connecticut group health plan would no longer qualify as a governmental plan if it permitted employees of certain nonprofit corporations to participate.
[21] See DOL Adv. Op. 2012-04A, which ruled that participation by multiple unrelated employers in an arrangement established by a service provider to fund and provide retirement benefits to employees would be deemed to be a series of ERISA-covered plans established by each of the participating employers.
[22] As with regulations promulgated by other federal agencies, DOL's interpretation of an ERISA provision generally is entitled to deference unless a court determines that it is unreasonable. *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842–43 (1984).
[23] DOL Regulation §2510.3-2(d).

- A Code section 408(a) IRA account must be maintained by a bank or an approved non-bank custodian.[24] The criteria for non-bank custodian approval are set forth in Treasury regulations and it will be impossible for States to qualify.[25]
- A Code section 408(b) IRA annuity must be issued by an insurance company qualified to do business in the State in which the IRA is issued;[26] however, the State itself is not a licensed insurance company. In addition, IRA annuities cannot have fixed premiums[27] and State IRA programs with default contribution rates are tantamount to annuities with fixed premium payments.

Accordingly, the regulatory safe harbor, by its terms, cannot apply to the State auto-IRA programs described above.

Further, even if the arrangements did involve tax-qualified IRAs and were to be analyzed under the regulatory safe harbor, they would not meet its conditions. A payroll deduction IRA is exempted from ERISA only if all of the following conditions are met:

- No contributions are made by the employer;
- Participation is completely voluntary for employees;
- The sole involvement of the employer is without endorsement to permit the sponsor to publicize the program to employees, to collect contributions through payroll deductions and to remit them to the IRA provider; and
- The employer or employee organization receives no consideration in the form of cash or otherwise, other than reasonable compensation for services actually rendered in connection with payroll deductions.[28]

The State Auto-Enrollment IRA Programs cannot meet at least two of these conditions.

Mandatory participation is not "completely voluntary." Auto enrollment, even with an opt out feature, has generally not been considered to satisfy the "completely voluntary" prong of the safe harbor. When DOL proposed an additional safe harbor exception for State-run IRA programs in 2016[29], it dropped the word "completely" from the "completely voluntary" participation requirement of the payroll deduction IRA safe harbor. The DOL explained:

> One of the 1975 payroll deduction IRA safe harbor's conditions is that an employee's participation must be "completely voluntary." The Department intended this term to mean considerably more than that employees are free to opt out of participation in the program. Instead, the employee's enrollment must be self-initiated.[30]

The DOL then noted that court interpretations of "completely voluntary" served to exclude plans with auto enrollment even with an opt-out provision.[31] Accordingly, the new safe harbor term

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[24] Code section 408(a)(2); Treas. Reg. §1.408-2(b)(2).
[25] Treas. Reg. 1.408-2(e). Among other requirements, non-bank custodians must satisfy ownership and net worth requirements that are inconsistent with status as a State or political subdivision thereof.
[26] Code section 408(b); Treas. Reg. §1.408-3(a).
[27] Code section 408(b)(2)(A).
[28] DOL Regulation §2510.3-2(d).
[29] This safe harbor was proposed and finalized by the DOL, but was subsequently revoked pursuant to a disapproval resolution issued pursuant to the Congressional Review Act.
[30] 80 Fed. Reg. 72006, 72008
[31] Id. at n.12, citing Doe v. Wood Co. Bd. Of Educ., 888 F.Supp.2d 771, 775–77 (S.D. W. Va. 2012) (Education Department regulations requiring "completely voluntary" choice of single-gender education not satisfied by opt-out provision); Schear v. Food Scope America, Inc., 297 F.R.D. 114, 125 (S.D.N.Y. 2014) ("For a voluntary 'tip pooling' arrangement to exist, it must be 'undertaken by employees on a completely voluntary basis and may not be mandated or initiated by employers' and an employer can take 'no part in the organization or the conduct of [the] tip-pool.' ") (quoting N.Y. Dept. of Labor Opinion Letter RO–08–0049). See also Carter v. Guardian Life Ins. Co., Civil No. 11-3-ART, 2011 WL 1884625, *1 (W.D. Ky. May 18,2011) ("Courts have held that employees'

was an attempt to "remove uncertainty" about ERISA coverage "by promulgating a 'voluntary' standard [rather than completely voluntary] that permits automatic enrollment arrangements with employee opt-out features."[32] Moreover, the DOL repeated itself in a footnote: "Of course...automatic enrollment of employees is not permitted under the existing payroll deduction IRA safe harbor."[33] The ERISA Advisory Council[34] has also determined that an automatic enrollment feature would take certain retirement plans out of a similarly worded safe harbor regulation excluding specific Code section 403(b) plans from ERISA coverage:

> The Council also considered, but is not recommending, that DOL permit the inclusion of an automatic enrollment feature within the context of an ERISA safe harbor 403(b) plan. The majority of Council members concluded that automatic enrollment would require actions typically performed by a plan sponsor/fiduciary (e.g., designation of a default investment alternative), and consequently, an automatic enrollment option in the plan may not be viewed as voluntary even in light of the participant's right to opt out of the automatic contributions.[35]

Accordingly, there is significant likelihood that both the DOL and a court would conclude that the programs at issue are not within the safe harbor and would therefore be subject to ERISA coverage, subjecting the State law to preemption.

Anticipated employer involvement exceeds that permitted by the safe harbor. The regulatory safe harbor is clear that the ***"sole"*** involvement of the employer must be limited to publicizing the program without endorsement and collecting and remitting premiums via payroll deduction.[36] The aforementioned State Auto-Enrollment IRA Programs, by contrast, depend on additional employer involvement, including:

- Calculation of contribution percentages and auto-escalation of amounts;
- Determination of eligibility of employees;
- Verifying social security numbers and other employee information, and reporting this information to the State;
- Conducting and providing open enrollment periods.

Moreover, in States where employers face fines for failing to comply with program requirements, employers may be expected to encourage participation in the program to avoid penalties, paperwork, etc. associated with an opt-out. It is easy to envision a small employer automatically enrolling new employees and thus inadvertently establishing an ERISA plan. This level of involvement is clearly beyond the scope contemplated by the safe harbor.

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participation is not 'completely voluntary' if their enrollment in the plan is 'automatic.' "); Thompson v. Unum Life Ins. Co., No. Civ.A. 3:03-CV-0277-B, 2005 WL 722717, *6 (N.D. Tex. Mar. 29, 2005) (analyzing group welfare plan safe harbor, 'Thompson's participation in the plan was automatic rather than voluntary"); cf. The Meadows v. Employers Health Ins., 826 F. Supp. 1225, 1229 (D. Ariz. 1993) (enrollment not "completely voluntary" where health insurance contract required 75 percent of employees to participate); Davis v. Liberty Mut. Ins. Co., Civ. A. No. 87-2851, 1987 WL 16837, *2 (D.D.C. Aug. 31, 1987) (health insurance enrollment not completely voluntary because employee would receive no alternative compensation for refusing coverage, therefore making refusal comparable to a cut in pay).

[32] Id.

[33] Id. at n.18.

[34] The ERISA Advisory Council, which was created by ERISA, is a 15-member board charged with advising the Secretary of Labor on ERISA issues and providing recommendations.

[35] See generally Advisory Council on Employee Welfare and Pension Benefit Plans, Current Challenges and Best Practices for ERISA Compliance For 403(b) Plan Sponsors (2011) (available at www.dol.gov/ebsa/publications/2011ACreport1.html).

[36] DOL Regulation §2510.3-2(d).

2. Preemption and Other Consequences of ERISA Coverage.

Based on existing case law, State IRA programs clearly are ripe for preemption as currently structured.

As described above, subject to certain exceptions not relevant here, ERISA preempts any and all State laws that relate to an employee benefit plan. A State law "relates to" an ERISA plan if, in the normal sense of the phrase, it has a "connection with" or "reference to" such a plan.[37] While not every indirect effect of a State law will mandate preemption, laws that even indirectly impact employee benefit plan administration are generally sufficient to warrant preemption. Specifically, the Supreme Court has held that State laws that mandate employee benefit structures and their operation provide alternative regulatory enforcement mechanisms, or bind employers or plan fiduciaries to particular choices are preempted because they "relate to" employee benefit plans.[38]

State Auto-Enrollment IRA Programs create structures that share these characteristics and clearly meet the "relate to" element of ERISA preemption in that they mandate the establishment, benefit structure, and terms of an employee benefit program.[39] These programs mandate a particular plan structure (automatic IRAs) as determined by each State legislature, with no flexibility left to employers. Employee contributions are transferred to the State program and managed in accordance with State mandates. The State would even choose the investment vehicles and managers that will offer plan administration. In most cases, the State also has its own enforcement mechanism, with penalties to employers for non-compliance.[40] Accordingly, if the State IRA Programs create employee benefit plans, the State laws creating and governing them are almost certainly preempted.

In addition, particular provisions of the legislation and regulations developed to implement these programs may be preempted regardless of whether the State IRA Program itself is determined to be an employee benefit plan. Recently, a lawsuit was filed against the State of Oregon challenging, as preempted by ERISA, the State's requirement that all employers register with the State and certify whether they maintain qualified retirement plans for their employees so as to be exempt from participation in the mandatory State IRA Program.[41] Similar lawsuits can be expected as implementation dates draw nearer.

As noted above, State Auto-Enrollment IRA Programs are not to be implemented if subject to ERISA coverage. However, the programs have implementation dates that are coming up sooner than the issue of preemption can make its way through the courts for an ultimate decision. Under current law, State Auto-Enrollment IRA Programs are likely to be determined by courts to be employee benefit plans subject to ERISA's provision. Moreover, it appears that the implementing legislation for these programs is likely preempted by ERISA. However, if these programs move forward, they will be adopted by employers and will be in place before these issues can make their way through the courts for an ultimate determination. This will leave employers holding ERISA-governed plans as a result of having been required to participate in the programs, and will create uncertainty regarding the retirement security for employees. In

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[37] Shaw v. Delta Airlines, 463 U.S. 85 (1983).

[38] See, e.g. Gobeille v. Liberty Mut. Ins. Co., No. 14-181, 577 U.S. ___, slip op. at 1, 13 (2016) (State law requiring the disclosure of certain information relating to health care services was preempted by ERISA to the extent that the State law applied to ERISA plan); Egelhoff v. Egelhoff, 532 U.S. 141, 147 (2001) (State statute that revoked a designation of the former spouse as a beneficiary of a benefit plan upon the divorce of the participant was preempted). See also New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 654 (1995); Ingersoll-Rand Co. v. McClendon, 498 U.S. 133, 142 (1990); Fort Halifax Packing Co. v. Coyne, 482 U.S. 1, 14 (1987).

[39] While certain State laws that relate to insurance or areas traditionally regulated by States may be saved from preemption, State IRA laws and do not fall into these narrow categories.

[40] California and Illinois impose penalties; Maryland employers lose a waiver of a business filing fee; and Connecticut permits a civil action to be brought to require compliance.

[41] The ERISA Industry Committee v. Read, Case No. 3:17-cv-01605 (D. Or. filed October 12, 2017).

addition, employers will become subject to ERISA's reporting and disclosure rules (e.g., Form 5500, plan document and summary plan description requirements). In addition, employers' responsibility and potential liability would increase due to their status as ERISA fiduciaries.

The likelihood of preemption, together with the uncertain treatment of programs that are established and in place before a court ultimately determines preemption, creates a challenge for employers that are forced to participate in these programs. Indeed, this dilemma illustrates the problem that the drafters of ERISA had intended to avoid through the broad preemption clause. While well-intentioned, the State Auto-IRA programs are not viable and alternatives should be explored.

Sincerely,

Vanessa A. Scott

Carol T. McClarnon

Allison E. Wielobob