STATE OF CONNECTICUT

RETIREMENT SECURITY BOARD

CO-CHAIRS: STATE COMPTROLLER KEVIN LEMBO & STATE TREASURER DENISE L. NAPPIER

Staff Report to CRSB

Re: Legal Memo to NCPERS (National Conference on Public Employee Retirement Systems) and AARP

January 5, 2015 CRSB Meeting

Segal Consulting firm, in coordination with K&L Gates, drafted a legal memo addressed to NCPERS and AARP on November 5, 2014 on the application of ERISA to the different types of plans states have considered for offering state-sponsored retirement plans for private sector workers. Below, please find the text from the sections of the memo that are relevant to the Connecticut plan:

<u>IRA Payroll-Deduction Exception from ERISA</u>

IRAs are not covered by ERISA (although they are covered by the Code) unless there is employer involvement. DOL regulations provide that an IRA made available by an employer to its employees will not be considered a pension plan covered by ERISA if

- there are no contributions made by an employer,
- employees participate in the IRA on a completely voluntary basis,
- the employer's activities with respect to the IRA are limited solely to –
    - permitting, without endorsement, the IRA sponsor to publicize its program to employees,
    - collecting contributions through payroll deductions or dues checkoffs, and
    - remitting those contributions to the IRA sponsor.

These are known as "payroll-deduction" IRAs.

<u>Payroll-Deduction IRA.</u>

The arrangement is designed to fall under the payroll-deduction IRA exception from ERISA coverage. It would not require federal legislation. An employer's only duty would be to withhold the IRA contribution and then submit the contribution to the trust (public-private arrangement) running the program. Employee participation would be automatic at a set amount but employees could opt out (or increase the amount). The trust entity could be designed to qualify as a permitted IRA sponsor under the Code or it could just serve as a middleman that transmits the payroll deductions as they arrive to a default IRA or to an IRA provider of the participant's choice from a pre-designated list. Once in the IRA, the normal IRA rules on moving IRA money would apply.

In the case of the default IRA (for those that did not give specific instructions), the IRA provider would invest the money conservatively (perhaps in a target fund). Fees of the state trust entity/middleman would be paid before each amount was forwarded and IRA providers could charge their normal set up fees. Annual tax reporting would come from the private IRA providers. (It should be noted that the payroll IRA ideas proposed as federal legislation by the President would work in a somewhat similar manner if it was voluntary, but without state involvement. That bill has not moved in Congress because of opposition to the mandatory nature.)

If establishing the payroll IRA was voluntary for each employer, it is highly likely that there would be no issue of ERISA preemption of the state law because the state would just be making the vehicle available. Some states are considering requiring employers that do not maintain any retirement plan to offer the payroll-deduction IRA. It is not clear whether such a state mandate would trigger ERISA preemption on the argument that it requires an employer to have a retirement vehicle. One argument against preemption would be that since the state law wasn't mandating creation of an ERISA plan (the payroll-deduction IRA would be designed to fall within the ERISA exception for payroll-deduction IRAs), ERISA preemption would not apply. Whether the DOL and the courts would agree is uncertain.

Please find complete legal memo here: http://www.dllr.state.md.us/retsecurity/retsecurityerisa.pdf