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MEMO

TO: State of Connecticut Retirement Security Board
DATE: July 31, 2015
FROM: Mercer and the Subcommittee
SUBJECT: Identifying eligible employers and employees

Introduction

A fundamental piece of the State of Connecticut Retirement Security Board's (the CRSB) final recommendations and report to the legislature is how to define which employers must offer the auto-enrollment IRA and the employees to which they must offer the program. Once these core elements are agreed, the administration, operational and enforcement pieces of designing the program will be developed. This memorandum outlines the Subcommittee's recommendation to the Connecticut Retirement Security Board (CRSB) for determining which employers must offer the auto-enroll IRA program and which employees should be auto-enrolled.

The Subcommittee spoke with Heidi Lane, Principal Attorney at the Connecticut Department of Labor (CDOL). Mercer also had discussions with Carl Guzzardi, Director of Unemployment Compensation Accounts at CDOL.

Determining the auto-enrollment population

The legislation must provide criteria for employers and a governing or enforcement body to use in deciding an employer's and / or employee's status. The key elements of the criteria are:

- Defining an employer,
- Clarifying what a "qualified employer savings plan" is for the statute purposes,
- Defining an employee for the purposes of determining headcount, and
- Identifying the employees to be auto-enrolled.

Recommendations on defining an "employer"

The current legislation provides the following employer definition as a starting point for the CRSB to evaluate and make recommendations:

> "Qualified employer" means any person, corporation, limited liability company, firm, partnership, voluntary association, joint stock association or other entity that employs five or more persons in the state. "Qualified employer" does not include: (A) The federal government, (B) the state or any

political subdivision thereof, or (C) any municipality, unit of a municipality or municipal housing authority."

This proposed definition is missing core elements. Employers can have multiple distinct, but related entities with employees. Defining what constitutes an employer is important for counting the number of employees toward the five employee threshold. Additionally, the proposed definition does not provide guidance as to the time frame over or a date on which to count employees.

The State's and federal laws provide several approaches for defining an employer. Connecticut has two acts that legislatively define an employer: the Family and Medical Leave Act (FMLA) and Paid Sick Leave Act (PSLA). The FMLA provides a definitional framework for classifying employers as "joint" (one person works for multiple related companies), "integrated" (a person works for an entity that has shared services, e.g. HR or payroll) or "successor" (a company purchases an existing entity). Under the FMLA, distinct operating entities can be consolidated for the purposes of counting employees.

Alternatively, Connecticut PSLA has legislation that defines an employer in accordance with the operating entity. For example, if one holding company has four operating subsidiary companies, then each operating company can be considered an employer and count only their employees.

At the federal level, the Internal Revenue Service (IRS) has rules for consolidating multiple entities into a "controlled group". The Employee Retirement Income Security Act of 1974 (ERISA) sections 414(b) and (c) require that all employees of commonly controlled corporations, trades or businesses be treated as employees of a single corporation, trade or business. The federal rules are more similar to the FMLA.

A primary reason for federal authorities to adopt an approach that looks across entities was to prevent employer discrimination abuses in establishing qualified plans. With ERISA qualified plans employers have greater incentives to create uneven access, as there are higher contribution maximums and the potential for contribution matching. Given that the auto-IRA program is the employee's money and the employer's resources are limited to payroll deduction, the incentives to create multiple corporate entities to evade responsibilities seem less likely. Consequently, the ability for the State to have governance and enforcement tools should be a bigger input into the CRSB's decision to aggregate across entities or count employees.

The Subcommittee considered federal and state approaches for defining an employer. The Subcommittee believes that adopting an existing state approach will be most familiar to employers and payroll vendors already working in the state. The Subcommittee also believes the definition should be simple and not add significant administrative burden or cost to oversee and implement. In reviewing the definitions, the Subcommittee concluded that the simpler approach is the PSLA definition.

The Subcommittee consider the date or time period for counting employees. According to the CDOL, the PSLA was amended to move away from counting employees over a time period because turnover overstates headcount, as there is no way over time to see fluctuations in staffing. For example, a firm with 10 employees at a quarter-end will report data for all people who were employees over the quarter; so, if the firm had 10 employees at the beginning of the quarter and lost 5 employees who

they replaced, the firm would show 15 employees on the payroll records. The CDOL recommended and the Subcommittee concurred that a specific date would be better for determining headcount. Because both the FMLA and the PSLA already use October first as a determination date the Subcommittee believes this date is sufficient for the auto-enroll IRA program. Additionally, October first may reduce some administrative burden for seasonal industries and industries with part-time minor workers, particularly in the summer.

Other states have considered whether only established going concerns should be required to auto-enroll employees. The Subcommittee considered this point, but concluded that giving employers a grace period for auto-enrolling new employees, e.g. 90 days, should alleviate the administrative burden of getting a payroll system implemented, so the Subcommittee recommends that newly established businesses (e.g., less than 1 year in operation) should not be exempt.

The Subcommittee considered whether distressed businesses or those currently in bankruptcy should be exempt. The Subcommittee believes that there are sufficient legal protections to protect unfunded employees deferrals in distressed business situations. The Subcommittee recommends not exempting these businesses from the mandate.

Consequently, the Subcommittee recommends the following definition:

> "Employer" means any person, firm, business, educational institution, nonprofit agency, corporation, limited liability company or other entity that employs five or more individuals in the state, which shall be determined based on such person's, firm's, business', educational institution's, nonprofit agency's, corporation's, limited liability company's or other entity's payroll for the week containing October first, annually. Such determination shall be made based upon the wage information submitted to the Labor Commissioner by the employer pursuant to subsection (j) of section 31-225a. The term "Employer" does not include: (A) The federal government, (B) the state or any political subdivision thereof, or (C) any municipality, unit of a municipality or municipal housing authority."

Recommendations on defining a qualified employer-sponsored plan

The legislation provides an exemption to the Program if the employer sponsors a “qualified” retirement plan. The Subcommittee considered the types of plans that should be considered for defining a “qualified” retirement plan. The Subcommittee determined that at a minimum the “qualified” plan should be active. For DB plans, this criteria means the plan is open to new accruals and vesting. For contribution-based retirement savings programs, this criteria means that the employee can contribute to their savings. Because some employer-sponsored plans do not allow employee deferrals and/or may not consistently provide employer contributions, the Subcommittee also recommends including minimum contribution requirements or employee deferral eligibility requirements to qualify a plan. The following plan types fall into the recommended definition of a qualified retirement plans:

- Payroll deduction IRA
- Simplified Employee Pension (SEP)
- Simple IRA
- Profit sharing, with 401(k) feature

- 403(b) (employer and/or employee contributions)
- Defined benefit plan (open to new participants and providing accruals)
- 457(b) plan

The following plans do not meet the recommended definition:

- Profit sharing (or 401(a) plan), without 401(k) feature
- Defined benefit plan (frozen to new participants and/or future accruals)
- Money purchase pension plan (employer contributions only)

Recommendations for defining "employee"

Employees may fall into many categories[1] based on the type of employment arrangement. Employers process payroll deferrals for all employee classes; however, the State may decide to exempt certain classes or employees from automatic enrollment. For example the State may want to consider retirement needs associated with an employee's classification, e.g. a minor worker.

Connecticut's FMLA legislation defines "eligible employees" as having been employed with the employer for 12 months and having done 1,000 hours of service in the 12 months immediately preceding the leave. The federal FMLA is generally the same, except the federal FMLA requires 1,250 hours of service in the preceding 12 months. The Subcommittee considered whether to exempt specific groups, such as temporary workers, part-time workers and minors. Recognizing that processing payroll deferrals for part-time, temporary or transient workers could result in higher administrative costs and require more employer resources, the Subcommittee concluded that having a 90-day grace period for auto-enrolling an employee would alleviate much of the costs associated with turnover in these employee groups. With regard to minors, there are no IRA minimum age requirements, although vendors may have self-imposed restrictions. The Subcommittee discussed the potential for small balances and many accounts to add to the overall program cost. This point will be considered in the financial feasibility discussion. Subject to a significant adverse financial impact, the Subcommittee recommends including all workers.

The Subcommittee considered whether auto-enrolling employees across multiple workplaces would end up with over-withholding, creating an unnecessary administrative burden and higher cost at the year-end for the individual and / or the State to correct the overage. The Subcommittee considered that the maximum deferral threshold of $5,500 would require a salary in excess of $90,000 per annum to create this problem. Since most of the covered population will not be earning at this salary level, the Subcommittee decided that the potential for creating an overage is low relative to the increase in overall savings from auto-enrollment. Additionally, the Subcommittee believes the incremental employer burden would not result in significant cost reduction or savings increases.

[1]Examples of employee categories are: business owner, spouse and other family members of business owner, full-time, part-time, seasonal, leased, "volunteer workers", unionized employees, non-resident aliens, temporary, interns, student workers, and minor workers.

Connecticut is a state with several shared borders. Some employees live in another state, but work in Connecticut. Based on discussion with CDOL, Mercer understands standard practice across the United States is that individual's compensation and domicile for payroll purposes are in the state in which their services are rendered. Consequently, employees living outside Connecticut are treated as employees if they work and receive wages in Connecticut. The Subcommittee recommends the Program will follow this approach.

Other recommendations

To supplement the employer definition, the Subcommittee recommends that the employee opt-in or opt-out take place immediately, but the covered employers can defer the enrollment set-up for up to 90 days from the start of employment.

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Appendix

Definition of "Employer" according to Connecticut Paid Sick Leave Act (PSLA)
31-57r(4)"Employer" means any person, firm, business, educational institution, nonprofit agency, corporation, limited liability company or other entity that employs fifty or more individuals in the state, which shall be determined based on such person's, firm's, business', educational institution's, nonprofit agency's, corporation's, limited liability company's or other entity's payroll for the week containing October first, annually. Such determination shall be made based upon the wage information submitted to the Labor Commissioner by the employer pursuant to subsection (j) of section 31-225a. "Employer" does not include: (A) Any business establishment classified in sector 31, 32 or 33 in the North American Industrial Classification System, or (B) any nationally chartered organization exempt from taxation under Section 501(c)(3) of the Internal Revenue Code of 1986, or any subsequent corresponding internal revenue code of the United States, as from time to time amended, that provides all of the following services: Recreation, child care and education.

Definition of "Employer" according to Connecticut Family Medical Leave Act (FMLA)
"Employer" means a person engaged in any activity, enterprise or business who employs 75 or more employees. The term "employer" includes:

(1) any person who acts, directly or indirectly, in the interest of an employer to any of the employees of such employer; and

(2) any successor in interest of the employer.

The term "employer" does not include the state, a municipality, a local or regional board of education, or a private or parochial elementary or secondary school. For purposes of sections 31-51qq-1 through 31-51qq-48 of the Regulations of Connecticut State Agencies, inclusive, the number of employees of an employer shall be determined on October first annually.

(a) Employer" is defined in section 31-51qq-1(i) of the Regulations of Connecticut State Agencies.

(b) Normally, the legal entity which employs the employee is the employer under FMLA. Applying this principle, a corporation is a single employer rather than its separate establishments or division.

(1) Where one corporation has an ownership interest in another corporation, it is a separate employer unless it meets the "joint employment" test discussed in section 31-51qq-3 of the Regulations of Connecticut State Agencies or the "integrated employer" test contained in subdivision (2) of this subsection.

(2) Separate entities shall be deemed to be parts of a single employer for purposes of FMLA if they meet the "integrated employer" test. Where this test is met, the employees of all entities making up the integrated employer shall be counted in determining employer coverage and employee eligibility. A determination of whether or not separate entities are an integrated employer is not determined by the application of any single criterion, but rather the entire relationship shall be reviewed in its totality. Factors considered in determining whether two or more entities are an integrated employer include: (A) Common management; (B) Interrelation between operations; (C) Centralized control of labor relations; and (D) Degree of common ownership/financial control.

Aligning the Different Approaches

The PSLA does not have a provision for combining employees from different entities to arrive at the minimum threshold number of employees for PSLA under the theories of joint or integrated employment. The Subcommittee has decided to adopt the PSLA approach of defining an employer.

The PSLA requires 50 employees or more, while FMLA requires 75 employees or more to be defined as an "employer." The Retirement Security Legislation contemplates 5 employees or more. The Subcommittee supports 5 employees or more as the cut-off.

FMLA excludes state, a municipality, a local or regional board of education, or a private or parochial elementary or secondary school, while PSLA excludes manufacturers and nationally chartered 501(c)(3) organization that provides all of the following services: recreation, child care and education (such as YMCA & YWCA). The Subcommittee has opted to reflect the exclusions contemplated in the Retirement Security legislation and the FMLA.

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