

MEMORANDUM

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From: Cathie Eitelberg, SVP and National Public Sector Market Director
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Date: November 5, 2014

Re: ERISA Protections

This memorandum has been prepared by Segal Consulting with legal review by David Morse and William Schmidt of K&L Gates. The memorandum addresses the rules and protections that exist under the Employee Retirement Income Security Act (ERISA). Its broad focus is the ERISA rules. Its narrower focus is how those rules would apply to three alternative ways for states to facilitate retirement benefits for workers of private employers located in the state.

ERISA's Structure

The Employee Retirement Income Security Act (ERISA) was passed in 1974 to help workers accumulate retirement benefits (defined benefit and defined contribution) and to assure that they received those benefits. Part I of Title I of ERISA, which is enforced by the Department of Labor (DOL), requires reporting to the DOL and disclosure to participants and beneficiaries. Part IV of Title I specifies fiduciary rules (e.g., duty of prudence, duty to act solely in the interest of participants and beneficiaries) and rules against prohibited transactions (i.e., strict rules against dealing with parties with an existing relationship with the plan). Part V of Title I includes rules on who can sue, when they can sue, the appropriate remedies, and preemption of most state laws relating to pension plans.

Title II of ERISA amended the Internal Revenue Code (Code) to set forth minimum standards that pension plans have to satisfy with respect to participation, vesting, and funding, as well as maximum benefit limits. The Internal Revenue Service (IRS) generally enforces these rules. The Code also includes an excise tax for prohibited transactions, including prohibited transactions involving IRAs.

Title IV of ERISA created the Pension Benefit Guaranty Corporation (PBGC), a government corporation funded by premiums from sponsors of defined benefit plans. The PBGC will pay benefits (up to certain guaranteed amounts) to participants and beneficiaries of defined benefit

plans if the plan has inadequate funds to pay promised benefits when the employer sponsoring the plan goes out of business or the plan is terminated underfunded during an insolvency.

Neither Title I nor Title IV applies to public plans. The Code provisions do apply, but in a special manner, to public plans.

Key ERISA Concepts

ERISA Plan and Preemption

Very generally, for an arrangement that provides retirement benefits to be considered a plan subject to ERISA, a private employer must have some continuing duties or responsibilities with respect to the arrangement. Generally, an employer contribution to the retirement arrangement will bring it under ERISA. If a plan is covered by ERISA, state laws relating to the plan are generally preempted. Although there is an exception for state laws regulating insurance, banking, or securities, the state cannot treat a plan as an insurance company or bank for purposes of those state laws.

IRA Payroll-Deduction Exception from ERISA

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.

Cash Balance Plans

A cash balance plan is a type of defined benefit plan in which workers have nominal (hypothetical) accounts that consist of pay credits (e.g., a percentage of compensation) and interest credits (which must be at no more than a market rate) that apply from the time the pay credit is contributed to the time the participant commences benefits. Annuities must be available but many cash balance plans also allow the participant to receive a lump sum payment of his or her nominal account. Because cash balance plans are defined benefit plans, the PBGC guarantees and premiums apply to cash balance plans. A cash balance plan cannot receive pre-tax employee contributions.

Multiple Employer Plan

A multiemployer plan is a plan to which more than one private-sector employer is required to contribute and that is maintained pursuant to one or more collective bargaining agreements between one or more employee organizations and more than one employer. This memo does not address or involve multiemployer plans. Rather, it involves and discusses multiple employer plans, which are essentially arrangements to provide benefits to the employees of two or more unrelated employers. The IRS and the DOL differ on whether an arrangement serving multiple employers is a multiple employer plan. The DOL will not treat a plan as a multiple employer plan for purposes of ERISA (even though it is so-treated for purposes of the Code) unless there is a “nexus” among the participating employers. The DOL treats a so-called “open multiple employer plan” as a collection of separate single-employer plans with a common service provider.

Possible Designs for States to Make Available Retirement Plans for the Employees of their Private Employers

Secure Choice Plan (SCP). The SCP is intended to be a multiple employer plan (at least under the Code and, if being in the state is a sufficient nexus, under ERISA). State enabling law would create a tax-qualified cash balance pension plan that would be available to the state’s private employers, including non-profit employers. Employers would have the option of participating; participation would not be mandatory. A private/state partnership would run a trust company created under state banking law with a Board of independent experts. The Board would act as trustee and could invest trust assets. The Board would be able to contract with the state to provide investment and record-keeping services or hire private entities to do that work. There would be no state liability. Trustees would pay or reimburse any costs incurred by the state.

Employee enrollment would be automatic but an employee could opt out. A participant’s benefit would be equal to the amount the person contributed, any employer contributions, and interest credits. The interest credits would be at the level specified by the state law (there would be a minimum career floor benefit). The benefit formula would provide a conservative basic benefit. If long-term investment performance was better than anticipated, the Board could increase benefits. The plan would pay benefits in the form of a lifetime annuity (with a default joint and survivor annuity if the participant is married). Benefits could start no earlier than age 65 (absent death or disability). The plan would not pay lump sums or make loans. A cash balance plan is not permitted to make hardship distributions.

While no Federal legislation is required, federal legislation would be helpful. Such Federal legislation could create special funding rules for SCPs. The federal legislation could also treat the SCP as a multiple employer plan for both the Code and ERISA. The federal legislation could change the current multiple employer rules so that the entire multiple employer plan would not be disqualified under the Code if one employers violated the Code rules.

Secure Choice Plan Lite (SCP Lite). The SCP Lite is an attempt to develop a simpler voluntary plan. There would be no federal legislative changes. Generally, the SCP Lite would have the same structure as the SCP. There could be employer contributions. Participation would be limited to employers with 100 or fewer employees to allow for simpler annual reporting.

Payroll-Deduction IRA. 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.

Employer and Employer View of ERISA

ERISA was enacted as a compromise. In return for increased protections for workers, employers were able to create plans that would be treated the same across the nation. The table below shows, in broad terms, which group is protected by specific provisions

ERISA Protection	Employee Protection	Employer Protection
Participation, vesting, funding	X	
Fiduciary rules	X	
Prohibited transactions	X	
PBGC guarantee	X	
Reporting	X	
Disclosure	X	
Preemption		X
Federal courts		X
ERISA remedies		X
Claims procedures	X	
Administrator discretion to interpret plan		X
Anti-alienation of retirement benefits	X	
Voluntary to establish a plan		X

The Appendix to this memorandum addresses the specific ERISA provisions in more detail and discusses how the provisions would apply to an arrangement facilitated by the state for its private employers.

APPENDIX

TOPIC	Qualified Plan Rules
ERISA Plan	<p>A payroll-deduction IRA is not an ERISA plan if the design meets the payroll-deduction IRA safe harbor exception of 29 CFR §2520.3-2(d). (See also DOL Interpretive Bulletin 99-1, which expands on the meaning of employer involvement in the regulation.) Under the regulation, the employer cannot make any contributions, employee participation must be completely voluntary, employer involvement must be limited to allowing the IRA sponsor to publicize its program to the workers, collecting contributions through payroll deductions or dues checkoffs, and remitting those contributions to the IRA sponsor.</p> <p>Unless there is a “nexus” among the employers, the DOL treats a cumulative arrangement as many, separate single-employer plans with a common service provider. It is not clear whether state sponsorship would be such a “nexus.”</p>
Maximum Benefit	<p>DB plans may provide a maximum annual annuity from employer contributions of \$210,000 in 2015 (this number is indexed). Employee contributions, whether mandatory or voluntary, to a cash balance plan count as a DC plan annual addition. In 2015, the maximum annual addition is \$53,000.</p> <p>IRAs have an annual maximum contribution limit of \$5,500 (in 2015) with a catch-up contribution allowed for those age 50 and above of another \$1,000.</p>
Employer Contributions	<p>Any employer contributions would bring a plan (including a payroll-deduction IRA) under ERISA.</p>
Pre-Tax Employee Contributions	<p>DB plans, including cash balance plans, may not accept pre-tax contributions or receive any contribution conditioned on a person making an elective contribution to another plan.</p> <p>The IRA rules are complicated. Generally, if neither spouse is an active participant in a qualified plan, they can make deductible contributions to an IRA. If one or both are active participants, then there are income tests as to whether deductible contributions are allowed. The income test is roughly \$100,000 if both are active participants and roughly \$180,000 if only one is an active participant. The limit for a single person is roughly \$60,000. Alternatively, a Roth IRA may be available if the participant meets certain different (somewhat higher) income standards. Contributions to a Roth IRA are not deductible but the contributions and all earnings are distributed tax free.</p>

TOPIC	Qualified Plan Rules
Preemption	<p>If ERISA covers a plan, state laws relating to the plan are generally preempted. Although there is an exception for state laws regulating insurance, banking, or securities, the state cannot treat a plan as an insurance company or bank for purposes of those state laws. If preemption applies, the state law cannot be enforced.</p> <p>Preemption allows multi-state employers to have one plan across the country. It also requires that disputes be litigated in federal courts and governs what remedies are available.</p>
Reporting	ERISA requires annual reports (Form 5500) to be filed with the DOL. Schedule SSA, which provides information on the benefits of separated participants, must be filed with IRS. Reporting is simplified for plans with fewer than 100 participants.
Disclosure	ERISA requires disclosure to participants and beneficiaries, including providing them with a summary plan description (SPD), summaries of material modifications (SMM), and an annual funding notice.
Fiduciary Duties	ERISA requires the fiduciary to act prudently and solely in the interest of plan participants and beneficiaries and that the assets of the plan be used for the exclusive benefit of participants and beneficiaries. The Code has similar rules.
Prohibited Transactions	ERISA has rules against party-in-interest transactions absent a statutory exemption, class exemption, or individual exemption. Virtually all prohibited transaction violations are subject to an excise tax under the Code. The Code imposes excise taxes on prohibited transactions related to ERISA-covered plans and IRAs. The absence of ERISA coverage should not affect the application of the prohibited transaction rules.
IRA Trustee	The trustee or custodian of an IRA must be a bank, a federal insured credit union, a saving and loan association, or an entity approved by the IRS to act as trustee or custodian. State law will have to make certain that the state trust entity meets those requirements if the entity is intended to function as an IRA trustee. State trust law will govern the trustee's actions. Trust law generally requires the trustee to act in the interest of the beneficiary of the trust, and the beneficiary can sue the trustee under state law if the trustee does not do so. If the state feels that state trust laws are too weak, the state can tighten them for these arrangements. There are also financial regulatory agency rules aimed at those investing IRA money; not all of those rules are as strong as the ERISA fiduciary rules.
Investment Options	ERISA allows plans to invest in whatever is prudent. IRAs generally can be invested in anything except certain "collectibles," including art, rugs, antiques, metals, gems, stamps, coins, and wines.
Participant Direction	Participant direction of investments is not allowed in a cash balance plan. IRA participants can switch investments in the IRA or switch to another IRA provider.
Claims Process	ERISA sets forth a benefits claim process that requires exhaustion of the plan's procedures and then access to federal court. In the case of an IRA (that was not covered by ERISA), the first step in many cases would be a contractually-required claim and arbitration process or procedures under federal regulatory agency rules depending on the violation. Other state remedies would be available because the IRA would not be an ERISA plan (so no preemption).
Who Can Sue	ERISA allows the Secretary of Labor to sue in addition to participants and beneficiaries. In the case of the IRA, generally the suit would be brought by the beneficiary of the IRA.
Remedies	ERISA provides for recovery of the benefit the participant should have received, no punitive damages, and attorney fees in the court's discretion. When the court can award participants equitable remedies and, if so, the types of remedies available still

TOPIC	Qualified Plan Rules
	have not been decided fully by the courts. In the case of a non-ERISA IRA payroll program, state remedies would be available because there would not be preemption. Financial regulatory agency rules might apply also.
PBGC Guaranty	<p>PBGC guarantees benefits under most private-sector DB plans (other than professional's plans with fewer than 25 active participants). To be covered by the PBGC, the plan must be an ERISA DB plan and tax qualified.</p> <p>In the case of an IRA, there is no PBGC coverage even if it fell under ERISA because it is not a DB plan. Amounts invested in insurance companies have some protection under state insurance guarantee funds. Amounts invested in mutual funds and certain other financial instruments have some protection under financial industry arrangements.</p>
Participation	ERISA and the Code generally require participation at 21 with one-year of service. This applies to those with a minimum 1000 hours of service in a year. A plan can be more generous on all aspects. In the case of the payroll IRA, the rules would depend on the state's design of the plan.
Vesting	ERISA and the Code generally require 5- year or phased 2-7 year vesting, although cash balance plans that pay a lump sum that is equal to the account balance must use 3-year vesting. A participant is always 100% vested in employee contributions to a plan or to an IRA.
Discrimination Rules	<p>Non-discrimination is not an ERISA requirement. The Code provides that a plan must cover a specific percentage of non-highly compensated employees (e.g. 70%) compared to the percentage of highly compensated employees covered. IRA's do not have to satisfy non-discrimination requirements.</p> <p>Under the IRS rules, each employer in a multiple employer plan is tested separately for nondiscrimination but if one employer is in violation, the entire multiple employer plan is disqualified. (This applies to any reason for disqualification, not only to disqualification because of nondiscrimination.)</p>

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