

# EXPANDING ACCESS TO RETIREMENT SAVINGS FOR SMALL BUSINESS

NOVEMBER 2015

## Introduction

While there is broad agreement that we have a retirement crisis in the United States, there is no consensus on how to address the issue. In part, this reflects the patchwork of existing programs from defined benefit to defined contribution to social security to individual retirement accounts (IRAs) and more.<sup>1</sup> Private sector employees who work for small businesses that do not offer a retirement plan are particularly at risk of not having sufficient savings to secure their retirement. Currently, it is estimated that one-third of private sector workers are employed by small businesses and more than half of these employers do not offer a retirement plan, which translates into millions of workers without access to an employer-sponsored plan.<sup>2</sup> Although a number of retirement plan options are available to small employers, including 401(k) plans, Simplified Employee Pension (SEP) IRAs, or Savings Investment Match for Employees (SIMPLE) IRAs, many small employers are reluctant to offer plans to their employees because of concerns regarding potential fiduciary liability as well as administrative complexity, burdens, and costs. Small employers often do not have the time to obtain the education and third party resources needed to establish a plan.<sup>3</sup>

While individuals can save on their own in a tax-favored way by using an IRA, there is low voluntary adoption of these accounts.<sup>4</sup> Research shows that individuals do not take the initiative to learn about their investment options, they do not take the affirmative steps needed to start saving, and they fail to make regular contributions.<sup>5</sup> Many retirement experts have expressed concerns that the Department of Labor's (DoL) proposed new definition of fiduciary threatens to exacerbate this problem, as the proposal will make it even more difficult and expensive for small employers and individuals to gain access to the education and advice they need to set up a plan, save, and invest for their retirement.<sup>6</sup>

There have been numerous federal proposals to promote retirement savings, however, the political stalemate in Washington DC makes it difficult to implement comprehensive reform. In response, more than half of the states have begun exploring their own solutions, often referred to as "public-private retirement plans," as they include private sector employees in publicly-run pension programs. While each state program has different features, the general idea is to provide individuals who do not have access to an employer-based retirement plan with an easy way to save and invest for retirement. Initially, these programs encountered a major stumbling block as the DoL expressed concern that state-based programs would be preempted by the Employee Retirement Income Security Act of 1974, as amended (ERISA).<sup>7</sup> However, at President Obama's request,<sup>8</sup> the DoL on November 16, 2015 issued both a proposed safe harbor regulation and an interpretive bulletin paving the way for states to adopt varying solutions that avoid or embrace ERISA and that should, in either case, not be encumbered by preemption concerns.<sup>9</sup>

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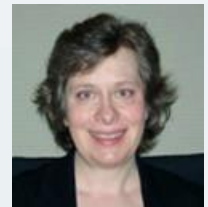
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## In this ViewPoint

- ▶ [Federal Initiatives](#) 2
- ▶ [State Approaches](#) 3
- ▶ [ERISA and Internal Revenue Code Considerations](#) 5
- ▶ [Suggestions to Reduce Burdens on Small Employers at Federal Level](#) 5
- ▶ [State-Based Retirement Program Considerations](#) 7

## KEY OBSERVATIONS AND RECOMMENDATIONS

- ▶ Private sector employees who work for small businesses are particularly at risk of having limited access to retirement plans and insufficient retirement savings.
- ▶ In the current political environment, there is a low likelihood of comprehensive retirement savings reform.
- ▶ Absent federal reform, multiple states are exploring their own programs for small and medium-sized employers.
- ▶ Federal and state governments should move forward with achievable changes to facilitate *both public and private sector retirement solutions*.
- ▶ The DoL's November 16, 2015 proposed regulation and guidance focus only on state programs, which may create regulatory arbitrage.
- ▶ The federal government should take additional actions that do not require legislation to reduce burdens on small employers:
  - Streamline and simplify reporting, disclosure, and testing obligations, particularly for small employers.
  - Facilitate broad private sector access to multiple employer plans (MEPs).
- ▶ All solutions should make it easier for employers to establish a plan or IRA program, encourage and facilitate continuous and increasing levels of retirement savings starting at an early age, and support well-designed investment programs.

States' reluctance to proceed with programs that might be subject to ERISA requirements highlights the burdens imposed by these rules. Given that ERISA was designed to protect the interests of plan participants and their beneficiaries, "we recommend a comprehensive review of legal/compliance burdens imposed by ERISA and similar state laws to determine what rules are truly necessary to protect participants."<sup>10</sup> In this *ViewPoint*, we review key federal retirement initiatives and several of the state proposals. We offer additional suggestions on how Congress and the DoL can eliminate unnecessary obstacles small employers face in establishing and maintaining ERISA plans and help further foster the development of state-based programs. We also provide our views on the benefits and challenges of state-based programs and desirable structures for them potentially to offer part of a solution, and we caution on the potential for creating regulatory arbitrage that may result in reduced retirement savings. In the absence of a comprehensive national solution, we believe that both the federal and the state governments should coordinate their efforts to achieve our shared goal of enabling Americans "to retire with dignity after a lifetime of hard work"<sup>11</sup> and move forward to implement achievable reforms that make it easier to establish a plan, increase savings starting at an earlier age, and access well-designed investment programs.

### Federal Initiatives

On the federal level, both President Obama and Congress have championed a variety of proposals to improve adoption of plans, retirement savings and investment outcomes. With the exception of President Obama's **myRA program**, these proposals have not advanced. **myRA** is a federally-backed savings program designed for lower and medium income individuals who are not currently saving and do not have access to an employer-based retirement plan. The *entirely voluntary* contributions are made to a Roth IRA via payroll

deduction and invested in a new Treasury retirement savings bond. The account can be rolled over at any time into a private-sector Roth IRA and will be automatically rolled over when the savings bond matures after 30 years or when its total value reaches \$15,000. Although a positive initiative, this program is not expected to have a significant impact on solving the retirement savings problem because it is entirely voluntary, an employee must take an affirmative step to enroll, and the absolute amounts that can be saved are relatively small.

Recognizing the retirement savings problem, President Obama has included an automatic IRA in each of his budget proposals since 2009. In early 2015, Senator Whitehouse and Representative Neal introduced President Obama's "**Automatic IRA Act**" in both chambers of Congress.<sup>12</sup> However, these bills have not progressed and are unlikely to be enacted.<sup>13</sup> Under President Obama's Fiscal 2016 Budget proposal, employers in business for at least two years that have more than ten employees would be *required* to offer a payroll-deduction, automatic IRA to employees. Employers who sponsor a qualified plan, SEP, or SIMPLE IRA, would be exempt. All employees who do not opt-out would be automatically enrolled at a default contribution rate of 3%, with assets contributed to a Roth IRA. Employees could elect to contribute at a different rate or to invest in a traditional IRA.<sup>14</sup> Employers would not be responsible for choosing or making investment decisions. Rather, a low-cost, standard default investment, such as a target date fund, and a small number of diverse low-cost investment alternatives would be prescribed by statute or regulation. Employers would not be required to make employer contributions, comply with the qualified plan rules of the Internal Revenue Code of 1986, as amended (the Code) or track IRA contribution limits, and the federal government would establish a website providing information and basic educational material.

Several other members of Congress have introduced bills offering a diverse range of proposals intended to address the “coverage gap”.<sup>15</sup> Each of these bills is complicated and none provides a comprehensive solution. Following are the highlights of a few of the federal legislative proposals:

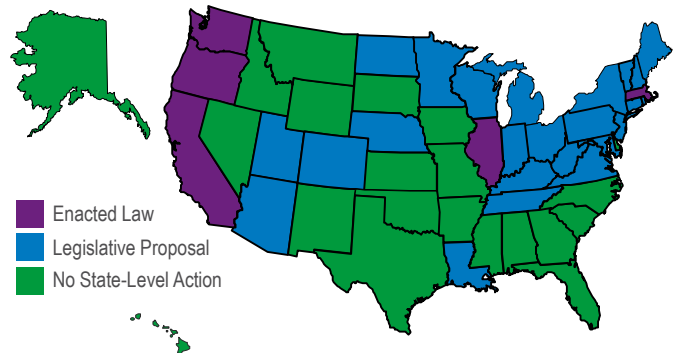
- ▶ **Allow Open MEPs.** A MEP allows businesses to share administrative and other responsibilities associated with establishing and maintaining a retirement plan. The MEP sponsor assumes overall fiduciary responsibility, files required reports, and handles many other administrative and recordkeeping tasks. Participating employers would be responsible for contributions and distributions, but would be relieved of fiduciary responsibilities assumed by the sponsor and shoulder a significantly lower administrative burden. Current judicial and regulatory rulings require that there be a “nexus” among the employers who participate in the MEP (e.g., multiple franchises of the same restaurant chain).<sup>16</sup> Legislative proposals would permit employers that do not share this nexus to participate in a single MEP. These proposals would go further than the recent DoL guidance, which is limited to state-based programs established as MEPs.
- ▶ **Provide Tax Incentives.** Both Senator Hatch and President Obama have proposed significant increases in tax credits and benefits for small employers that establish plans and to promote auto-enrollment and higher levels of employer matching contributions.
- ▶ **Enhance Benefits of Lifetime Income Products.** To help preserve savings and encourage the use of products that provide a predictable income stream throughout retirement, some proposals exclude a portion of annuity payments from gross income and seek to facilitate portability of annuities. There are also proposals to require plan sponsors to provide projected lifetime income illustrations to employees.

### State Approaches<sup>17</sup>

More than half of the states have introduced or adopted legislation that would provide a state-based retirement program. Exhibit 1 depicts the states that have enacted, considered, or are considering state-based retirement programs. State legislation and legislative proposals grapple with multiple structural and cost issues including: (a) how to fund the costs of establishing and maintaining a program; (b) levels of expected participation; (c) whether a program should impose a mandate on the employer and, if there is an employer mandate, whether employee contributions should be mandatory, automatic with an opt-out, or fully voluntary; (d) the appropriate level of employee contributions; (e) how assets should be invested and whether benefits should be guaranteed or insured; and (f) applicability of ERISA and favorable federal tax treatment.

In considering these programs, states are also concerned with dis-incentivizing employers who currently offer a plan from continuing to do so – a problem they confronted with the Affordable Care Act – and potentially compounding the retirement savings problem.

### Exhibit 1: STATE-BASED RETIREMENT PROGRAMS



Source: U.S. Government Accountability Office as of September 2015; Georgetown University Center for Retirement Initiatives.

As illustrated in Exhibit 2, the existing state initiatives predominately fall into two distinct types: (a) payroll deduction IRAs, similar to President Obama’s proposed “Automatic IRA Act”, but at the state level and (b) retirement marketplaces. California, Illinois, and Oregon have enacted legislation that would structure a program as a mandatory payroll deduction IRA. Washington state has adopted a different approach, which they are calling a “retirement marketplace.” Washington state relies on education and the private sector’s existing offerings (as well as the federal *myRA* program) in an effort to make it easier for small employers and individuals to establish plans. Initial legislation enacted in Massachusetts has a different focus. It authorizes a state-sponsored defined contribution prototype plan, subject to ERISA, that could be adopted by not-for-profit employers with 20 or fewer employees. Massachusetts is considering other proposals that include an employer mandate, including a proposal that would require employers with 10 or more employees to either (1) establish a plan, (2) participate in a MEP created by the state or (3) automatically enroll employees into an IRA created by the state. Other state proposals and feasibility studies are examining program structures and concepts similar to those adopted by states that have already enacted legislation.<sup>18</sup>

## Exhibit 2: STATE RETIREMENT INITIATIVES

The state programs included below have been approved through legislation and are in different stages of implementation.

### California Secure Choice Retirement Savings Program<sup>19</sup>

- ▶ Program must be self-sustaining, qualify for favorable federal tax treatment and not be subject to ERISA; legal and market analysis in progress
- ▶ Mandatory state-sponsored payroll deduction IRA for private employers with five or more employees that do not offer a retirement plan
- ▶ Automatic three percent payroll deduction, with individual right to opt out
- ▶ Requires a guarantee to protect value of the retirement accounts<sup>20</sup>

### Illinois Secure Choice Retirement Savings Program<sup>21</sup>

- ▶ Must be implemented within 24 months unless adequate funds not obtained. Program must be self-sustaining, qualify for favorable federal tax treatment and not be subject to ERISA
- ▶ Mandatory state-sponsored payroll deduction IRA for private employers with twenty-five or more employees operating for two years that do not offer a retirement plan
- ▶ Automatic three percent payroll deduction, with individual right to opt out
- ▶ Assets would be professionally managed, with a privately-underwritten guarantee<sup>22</sup>

### Oregon Retirement Savings Plan<sup>23</sup>

- ▶ Establishes a Retirement Board to develop a defined contribution plan and conduct market and legal analysis by December 31, 2016 to address feasibility, applicability of ERISA, costs to employers and time line for implementation
- ▶ Employers required to offer the state program unless they offer an alternative
- ▶ Automatic enrollment with a default contribution rate set by the Board and permits employees to opt out
- ▶ Assets would be pooled and professionally managed

### Washington State Small Business Marketplace<sup>24</sup>

- ▶ Financial literacy education and outreach
- ▶ Marketplace connects eligible individuals and employers with private sector plans
- ▶ Prescribes types of plans (e.g., simple IRA or other IRS approved) and investment offerings (e.g., target date and balanced funds)
- ▶ Entirely voluntary
- ▶ Plans may be subject to ERISA and individuals must have the option to roll over to different retirement accounts

### Massachusetts State Sponsored 401(k) Plan

- ▶ Plan would be subject to ERISA
- ▶ State-sponsored 401(k) for non-profits with twenty employees or fewer
- ▶ Participation is voluntary
- ▶ Automatic six percent payroll deduction to a 401(k) account (but employer can opt for 4% with automatic escalation up to 10%)
- ▶ Participants have retirement planning resources, including projected retirement income



## ERISA and Internal Revenue Code Considerations

### Complexity for Small Employers

ERISA was enacted to, among other things, protect the interests of plan participants and their beneficiaries and set minimum standards for most private sector pension plans.<sup>25</sup> ERISA imposes general fiduciary standards on those who establish and maintain a plan and includes broad and complex prohibited transaction rules. In a defined contribution plan, these fiduciary duties include the obligation to select and monitor appropriate investment options for employees.

ERISA and the Code impose significant administrative burdens and associated costs on plan sponsors, including maintaining plan documents, providing specific disclosures to participants and beneficiaries, ensuring compliance with non-discrimination rules, and filing of government reports. Virtually all plans, including those sponsored by small employers, are required to submit Form 5500 to the federal government.<sup>26</sup> Small employer defined contribution plans must provide participants (subject to certain exceptions and alternative reporting for SEP or SIMPLE IRA plans) with a periodic benefit statement,<sup>27</sup> a summary annual report,<sup>28</sup> a summary plan description,<sup>29</sup> notice of an opportunity to change elective deferrals<sup>30</sup> and the ERISA-required participant disclosures.<sup>31</sup> If a plan uses automatic enrollment with investment into a qualified default investment alternative (QDIA), it must provide another specific notice to employees annually.<sup>32</sup> The instructions for required forms are often confusing and, for many small plan sponsors, it is complicated just to determine whether they need to complete a certain form or provide a particular disclosure.<sup>33</sup>

The Code's non-discrimination rules, designed to ensure that plans do not only benefit highly compensated employees, must be satisfied to obtain and maintain tax qualified status. The rules tend to disproportionately burden small employers,<sup>34</sup> as the top-heavy requirements are complex and burdensome and, depending on the type of plan, may require annual testing. Basically, if contributions for highly-compensated employees are too high in relation to contributions for non-highly compensated employees, as calculated under complicated Code rules, then a plan will fail the test and contributions must be adjusted. This results in additional administrative burden, refunds to highly compensated employees, and corrective contributions for non-highly compensated employees. The existing safe harbors from non-discrimination testing require employer matching or profit sharing contributions, which may be too expensive for a small employer and/or too difficult to sustain over an extended period of time. SEP and SIMPLE IRA plans offer a less complicated alternative, but these plans require employer contributions, which are expensive.<sup>35</sup> Simply put, the complex and burdensome requirements of ERISA and the Code deter small employers from establishing

and maintaining plans. We believe that, in certain cases, rules may be eliminated or simplified without creating the risk of harm to participants and beneficiaries that ERISA and the Code seek to avoid or having other adverse impacts to the US retirement system as a whole.<sup>36</sup> In addition to continuing to pursue current legislative initiatives, and as we noted in our September 2013 *ViewPoint*, we urge Congress, the DoL and Treasury to review the statutory and regulatory requirements and consider alternative legislative and regulatory changes that critically focus on eliminating unnecessary obstacles and simplifying and clarifying legal obligations, particularly those relating to reporting and disclosure, for small employers.

### Suggestions to Reduce Burdens on Small Employers at Federal Level

- ▶ Simplify ERISA reporting and disclosures (including eliminating Form 5500 filings entirely for defined contribution plans that offer only registered mutual funds, bank maintained collective funds or index separate accounts as investment alternatives)
- ▶ Eliminate “top heavy” testing for small employer plans
- ▶ Facilitate private sector sponsored open employer MEPs

We echo the recommendation of the GAO<sup>37</sup> for the DoL and Treasury to work together to improve accessibility to plan information and education. The agencies should jointly consolidate material relevant to small employer retirement plans into a single, easy-to-use web portal. The portal should not only contain technical requirements (e.g., placing instructions for all reporting/disclosure obligations for various plan types in a single place along with plain English instructions), but should also include basic and easy to understand retirement education, including the benefits of establishing and maintaining a plan, the importance of savings, and clear descriptions of investment options. Following the approach of the Washington state retirement market place, the website could provide information regarding where small employers can get additional help from private sector service providers (e.g., links to financial services firms that can help them set up a plan). This would be a valuable tool to enable small employers to better connect the dots and take action. In Interpretive Bulletin 2015-02, the DoL helpfully provided guidance that would facilitate offering a state-sponsored MEP.<sup>38</sup> This guidance determined that a state's interest in the well-being of its citizens provides a sufficient nexus with the MEP, such that the state could establish a single “employee benefit plan” under Title I of ERISA that multiple diverse employers could adopt. However, the DoL's guidance is narrowly focused on state-based retirement initiatives. We urge Congress and/or the DoL to take the further step of facilitating adoption of private-sector MEPs by eliminating the “nexus” requirement for these plans.

Similar to suggested state-sponsored MEPs, employer involvement could be limited to making a decision to adopt the MEP, ongoing monitoring of the MEP, facilitating employee enrollment, making contributions and arranging for distributions. The reduced fiduciary responsibilities along with reduced risk and administrative and management burden of an open MEP could help encourage small employers to adopt a plan.

### **ERISA Preemption of State Efforts**

A threshold legal issue for state retirement programs is whether they are preempted by ERISA. ERISA supersedes all state laws that “relate to” an employee benefit plan subject to ERISA,<sup>39</sup> and courts have construed the words “relate to” broadly. State legislators and industry participants have expressed concern that the requirement for mandatory private-sector employer participation and payroll withholding creates an “employee benefit plan” subject to ERISA. If a state-based program is subject to ERISA, that would, at a minimum, increase complexity and cost – one of the key things the state-based initiatives are working to avoid – and could render the state legislation at least partially ineffective.

Moreover, a number of states examining the viability of automatic payroll deduction IRAs have determined that it is critical that ERISA not apply. The state requirement that programs be exempt from ERISA highlights the importance of providing relief to small employers in particular from unnecessary and overly complicated rules under ERISA and the Code. Initially, invoking ERISA preemption, the DoL indicated that state-based programs could create significant liability for a state and its private employers.<sup>40</sup> In the DoL’s view, ERISA preemption needed to be decided by the courts; it could not provide any certainty to the states through agency action.<sup>41</sup> It suggested that a path forward may be to grant temporary waivers of ERISA preemption to evaluate different types of plans, if President Obama’s pilot waiver program was funded.<sup>42</sup> This was an impractical approach at best, as states are unlikely to devote the time and resources needed to establish a new program if, from inception, there is legal uncertainty regarding whether it could be maintained over time.

On July 13, 2015, President Obama directed the DoL to issue guidance that would clarify the path forward for state-based retirement savings initiatives, including with respect to requirements to automatically enroll employees and for employers to offer coverage for workers who do not currently have access to a retirement plan at work.<sup>43</sup> President Obama declared that, since Congress would not act on an automatic IRA, the White House wanted to do everything possible to encourage states to establish automatic enrollment programs.<sup>44</sup> Responding to the President’s directive, the DoL released a proposal for a regulatory change and issued an interpretive bulletin to help facilitate state-based programs on November 16, 2015. The public will have 60 days to comment on the proposed rule before the rule is final.

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The proposed regulation describes a safe harbor, under which a state-mandated payroll deduction IRA program would not be treated as an ERISA-covered plan and should not be preempted by ERISA. Specifically, the DoL proposal adds a new regulatory exclusion from the definition of “employee benefit plan”.<sup>45</sup> One of the DoL’s long-standing exclusions from ERISA applies to an “employer-facilitated” IRA. This exclusion, among other things, requires that employer involvement be limited to publicizing the program and collecting contributions through payroll deductions, and that employee participation be completely voluntary. The safe harbor described in the DoL’s proposal contains a similar limitation on the role of the employer and requires that state programs to be voluntary for employees (i.e., programs that require automatic enrollment must provide employees with an opportunity to opt out). In addition, the safe harbor contains conditions focused on the role of the state. The state must establish and administer the program pursuant to state law and it must be responsible for the security of payroll deductions and savings, selecting investment alternatives, notifying employees of their rights under the program, and creating a mechanism for the enforcement of those rights.

The proposed rule could be a promising step in the right direction, but, if adopted without broader reforms to ERISA and Code requirements at the federal level, it risks creating regulatory arbitrage. Although the DoL’s Interpretive Bulletin also provides useful analysis that a state program structured as an ERISA-compliant MEP or prototype plan should not be preempted by ERISA because it may include an employer mandate, many states may be unwilling to structure ERISA-compliant MEPs or prototype plans because of the associated complexity and liability risks. The proposed rule thus could create the unintended consequences of incenting small employers that have adopted ERISA plans to stop offering them in favor of the simpler state alternative and discouraging small employers that have not adopted an ERISA plan from doing so in the future. In many cases, this could lead to reduced retirement savings, thus defeating the purpose of these state programs. This risk provides yet another compelling reason why Congress, the DoL and Treasury should intensify their efforts to achieve reform at the federal level and focus particularly on streamlining and simplifying requirements for employers with under 100 employees.

## State-Based Retirement Program Considerations

### Structure

Innovative state programs with the following characteristics, similar to those in President Obama's "Automatic IRA Act", represent a potentially promising tool to help individuals save and invest wisely for retirement: (i) programs are structured as IRAs (or as open MEPs if states are willing to accept ERISA responsibilities); (ii) employers that do not otherwise offer a plan are *mandated* to withhold a specific percentage of each employee's pay, but employees may affirmatively opt out; and (iii) assets are automatically contributed to an investment that could qualify as a QDIA, as defined in ERISA, and additional investment options are simple, diversified and consistent with those that would be available in a plan that satisfies the requirements under Section 404(c) of ERISA (e.g., at least three diversified investment alternatives).<sup>46</sup> To further enhance their programs, states should provide significant and easy to understand retirement education, including education and tools that can assist individuals in determining, achieving and managing desired income levels in retirement. As electronic investment advisory services (e.g., digital wealth management providers) become more established, states can consider ways to incorporate these services to help participants with additional investment advice. Finally, to facilitate rollovers from the state program to a personal IRA, states could follow the example in Washington state and work with IRA providers to establish a portal or marketplace that makes the process simple and inexpensive.

### Benefits of Suggested Structure

State-based mandatory payroll deduction programs (with or without providing the employee a right to opt out) offer a number of benefits that could improve retirement outcomes for individuals who work for small employers that do not currently offer a plan. They are simpler and, if exempted from ERISA or structured as open-MEPs, they should have lower administrative burdens and costs than those described above associated with establishing a single employer plan (i.e., documentation associated with establishing a plan, transmitting documents to employees, regulatory filings, etc.). For plans structured as IRAs, the employer should not have fiduciary responsibility; the employer's only obligations would be to provide information to employees and to arrange payroll deduction for them. For plans structured as open-MEPs, the employer's fiduciary responsibility would be limited. Since assets would be pooled for investment purposes, institutional asset management expertise and a lower cost structure could become available to these small businesses and their employees.

Most importantly, automatic or mandatory payroll deduction represents an effective way to improve savings. Studies show that if savings are "automatic", more people will save more.<sup>47</sup> The Pension Protection Act of 2006 (PPA) is a good example of a legislative change that improved savings by making saving easier. Through the PPA, Congress and the DoL enacted legislation and implemented regulations designed to make it simple to increase savings and improve investment of those savings.<sup>48</sup> The PPA provided for automatic enrollment, automatic escalation, and QDIAs, which were intended to collectively improve retirement outcomes. An investment qualifying as a QDIA is intended to be a single investment capable of meeting a worker's long-term retirement savings needs. Research has shown that the PPA has positively impacted participation rates, particularly among younger employees.<sup>49</sup> The number of companies using automatic enrollment and automatic escalation in the United States continues to increase. Based on this success and recent legislative efforts, automatic enrollment of military personnel in the federal Thrift Savings Plan appears likely to be implemented in 2018.<sup>50</sup>

Sometimes it is useful to evaluate and consider programs or specific features that are used in other jurisdictions. The United Kingdom implemented reforms that require private sector employers to automatically enroll eligible workers in a workplace retirement savings program and created the National Employment Savings Trust (NEST) to provide employers with essentially a default investment option for employee contributions.<sup>51</sup> This initiative, which is analogous to the automatic IRA approach adopted or being considered by states, has succeeded in bringing individuals into retirement savings programs, and fewer people have opted out than predicted.<sup>52</sup> Automatic enrollment has also been used effectively in New Zealand's KiwiSaver program, and government officials have maintained that "automatic enrollment is critical because too many people – even those who want to save – will not actively seek out participation."<sup>53</sup> These examples provide encouragement to proceed.

### Potential Disadvantages

State-based automatic payroll deduction programs raise a number of concerns. It is expensive for states to establish a program and then maintain an operational and compliance infrastructure. It will also be costly for states to provide ongoing needed investment education and/or advice. Most of the current state mandatory payroll deduction IRA proposals require that the programs be self-sustaining, which could be a difficult hurdle to overcome. Over time one would reasonably expect that the ongoing costs should be less than those associated with establishing a single employer plan; however, startup costs, in particular, could be significant, and public funding may be needed.

To fund NEST, the low-cost default provider in the United Kingdom, contributions are subject to an additional fee of 1.8 percent until those costs are recouped.<sup>54</sup> KiwiSaver was initially funded through a combination of government subsidies and incentives which were gradually eliminated or reduced over time.<sup>55</sup>

State-based IRA programs structured so they are not subject to ERISA, as provided under the DoL's proposed rule, could discourage small employers from establishing an ERISA qualified plan. Considering the complexities of ERISA and Code requirements, small employers may opt for a simpler and less costly state alternative. IRA contribution limits are significantly lower than those applicable to 401(k) and other ERISA plans, and this could result in individuals saving less through state programs. In the absence of simplification of ERISA and Code requirements, employers weighing the benefits of the alternatives could be driven to use the state program.<sup>56</sup>

Some critics are concerned that states could not adequately establish and administer a state-based retirement program, particularly given the precarious status of some public pension plans and issues associated with the roll out of the Affordable Care Act. While the DoL's guidance facilitates state-sponsored MEPs and prototype plans subject to ERISA, it does not resolve concerns regarding the state's willingness to accept ERISA responsibility or their practical ability to implement a program subject to the extensive requirements in ERISA and the Code.

Several of the state programs contemplate the inclusion of a guarantee. Both principal and income guarantees may be difficult to obtain. Even if a provider is identified, the cost may be prohibitive.

Another major concern with state programs is portability. If an employee relocates from one state to another, what happens to their retirement savings? Would the employee need to roll into an IRA? Could the employee stay invested in the state program without making additional deposits? What would happen to a guarantee or insurance benefit, such as those included in the California and Illinois programs? These questions would need to be resolved before launching a program.

## Conclusion

Americans are living longer and increasingly must rely on their own savings to fund their retirement. In the current political climate there is a low likelihood of comprehensive reform at the federal level, including legislation to mandate or require automatic retirement savings. Given this landscape, we urge Congress, the DoL, Treasury and the states to coordinate and to consider and implement workable alternative solutions in both the private and the public sectors that move retirement savings in the right direction.

At the federal level, a review of the burdens of ERISA and Code rules on small employers could lead to a streamlining of reporting and testing requirements. We believe additional employers would offer plans (and states could be more willing to adopt open MEPs) if the costs, administrative burdens, and risks were addressed. The federal government should also take further steps to facilitate private sponsors of open MEPs.

In addition, we welcome innovation at the state level to create potential retirement savings solutions. As noted earlier, there are significant hurdles that need to be overcome, and it is important to avoid an outcome in which these public solutions crowd out the private sector or create a regulatory arbitrage that inadvertently results in lower savings. We caution that exempting the public IRA programs from ERISA without addressing the private sector solutions may lead to small employers opting-out of offering plans to employees even if the resulting benefit to employees is less than what they currently receive.

In conclusion, as the federal and state governments move forward in addressing the challenges of securing retirement, it is critical that they ensure that their initiatives offer solutions that:

1. Make it easier for employers, in particular small employers and individuals, to establish a plan or IRA.
2. Encourage and facilitate continuing and increasing levels of retirement savings, starting at an early age.
3. Support well-designed investment programs for individuals planning to retire and those in retirement.



## Notes

1. BlackRock *ViewPoint*, Addressing America's Retirement Needs: Longevity Challenge Requires Action (Sep. 2013) at 2, available at <http://www.blackrock.com/corporate/en-us/literature/whitepaper/viewpoint-retirement-needs-092013.pdf> (BlackRock September 2013 Retirement *ViewPoint*).
2. GAO, Testimony Before the Committee on Health, Education, Labor, and Pensions, U.S. Senate, Statement of Charles A. Jeszeck, Director Education, Workforce, and Income Security, "Retirement Security: Challenges and Prospects for Employees of Small Business" (Jul. 16, 2013) at 1, available at <http://www.gao.gov/assets/660/655889.pdf>.
3. Id. at 9-10.
4. David C. John and William G. Gale, "Structuring State Retirement Saving Plans: A Guide to Policy Design and Management Issues" (Sep. 2015) at 2, 6-7, available at <http://www.brookings.edu/~media/Events/2015/10/07-state-pensions/structuring-state-retirement-saving-plans.pdf?la=en>.
5. See e.g., Jodi DiCenzo and Paul Fronstin, "Lessons From the Evolution of 401(k) Retirement Plans for Increased Consumerism in Health Care: An Application of Behavioral Research," Employee Benefit Research Institute, Issue Brief No. 320 (Aug. 2008) at 13-15, available at [http://www.ebri.org/pdf/briefspdf/EBRI\\_IB\\_08-2008.pdf](http://www.ebri.org/pdf/briefspdf/EBRI_IB_08-2008.pdf).
6. For more information, see BlackRock, Comment Letter, Definition of the Term "Fiduciary"; Conflict of Interest Proposed Rule - Department of Labor (Jul. 21, 2015), available at <http://www.blackrock.com/corporate/en-us/literature/publication/dol-definition-of-fiduciary-conflict-of-interest-proposed-rule-072115.pdf>.
7. At a hearing of the Oregon Task Force on Retirement Savings, DoL staff said that a state run retirement plan for private sector workers could create significant liability for the state and its private employers. Joint Interim Task Force on Oregon Retirement Savings (HB 3436) (Jun. 10, 2014); See also DoL Advisory Opinion 2012-01A (Apr. 27, 2012), available at <http://www.dol.gov/ebsa/regs/aos/ao2012-01a.html> ("Participation of private nonprofit employers in the Connecticut State Plan...would adversely affect the status of the State Plan as governmental plan under ERISA section 3(32).")
8. The White House, Office of the Press Secretary, "Remarks by the President at White House Conference on Aging" (Jul. 13, 2015), available at <https://www.whitehouse.gov/the-press-office/2015/07/13/remarks-president-white-house-conference-aging> (President Obama's Remarks at White House Conference on Aging).
9. Notice of Proposed Rulemaking, Savings Arrangements Established for Non-Governmental Employees, RIN 1210-AB71 (Nov. 16, 2015) (DoL State-IRA Proposal). Interpretive Bulletin 2015-02, Interpretive Bulletin Relating to State Savings Programs that Sponsor or Facilitate Plans Covered by the Employee Retirement Income Security Act of 1974, RIN 1210-AB74 (Nov. 16, 2015) (IB 2015-02).
10. BlackRock September 2013 Retirement *ViewPoint* at 11.
11. DoL Fact Sheet, Department of Labor Proposes Rule to Address Conflicts of Interest in Retirement Advice, Saving Middle-Class Families Billions of Dollars Every Year at 1, available at <http://www.dol.gov/protectyoursavings/FactSheetCOI.pdf>.
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16. DoL Advisory Opinion 2012-03A (May 25, 2012), available at <http://www.dol.gov/ebsa/regs/aos/ao2012-03a.html> (DoL Advisory Opinion 2012-03A); DoL Advisory Opinion 2012-04A (May 25, 2012), available at <http://www.dol.gov/ebsa/regs/aos/ao2012-04a.html> (DoL Advisory Opinion 2012-04A); *MDPhysicians & Associates, Inc. v. State Bd. Ins.*, 957 F.2d 178, 185 (5<sup>th</sup> Cir.), *cert. denied*, 506 U.S. 861 (1992).
17. American Council of Life Insurers, US Retirement Facts, "State Activity", available at <http://www.usretirementfacts.com/state-activity-2/> (ACLI State Activity Overview); Georgetown University, McCourt School of Public Policy Center for Retirement Initiatives, "Look to the States for Innovation", available at <http://cri.georgetown.edu/states/all-states/> (Georgetown State Retirement Programs Overview); September 2015 GAO Retirement Security Report.
18. ACLI State Activity Overview; Georgetown State Retirement Programs Overview.
19. California Secure Choice Retirement Savings Trust Act, Cal. Gov't. Code Tit. 21 § 20139 (2012), available at [http://leginfo.ca.gov/faces/billNavClient.xhtml?bill\\_id=201120120SB1234](http://leginfo.ca.gov/faces/billNavClient.xhtml?bill_id=201120120SB1234).
20. California and Illinois legislation requires a guarantee feature, however, they do not specify who will provide the guarantee or how it will be structured.
21. Illinois Secure Choice Savings Program Act, Ill Pub. Act 098-1150 (2015), available at <http://www.ilga.gov/legislation/publicacts/98/PDF/098-1150.pdf>.
22. See footnote 17.
23. Oregon Laws 2015 (Enrolled House Bill 2960) (2015), available at <https://olis.leg.state.or.us/liz/2015R1/Downloads/MeasureDocument/HB2960/Enrolled>.
24. Washington State ESSB 5826 (2015), available at <http://lawfilesexxt.leg.wa.gov/biennium/2015-16/Pdf/Bills/Senate%20Passed%20Legislation/5826-S.PL.pdf>.
25. 29 U.S.C. § 1001(b) and 1003(a).
26. 29 U.S.C. § 1024(a).
27. 29 U.S.C. § 1025; DOL Field Assistance Bulletin 2006-3 and 2007-3.
28. 29 U.S.C. § 1024(b); 29 C.F.R. §§ 2520.104b-10, 2520.104-46(b) and 2520.104b-1.
29. 29 U.S.C. §§ 1022 and 1024; 29 C.F.R. §§ 2520.102-2, 2520.102-3, 2520.104b-1, 2520.104b-2, and 2520.104b-3.
30. 26 C.F.R. §§ 1.401(k)-1(e)(2)(ii) and 1.403(b)-5(b)(2).
31. 29 C.F.R. § 2550.404a-5.

## Notes (cont'd)

32. 29 U.S.C. § 1104(c)(5).
33. GAO, Report to Congressional Requesters, Private Pensions, Clarity of Required Reports and Disclosures Could Be Improved. GAO-14-92 (Nov. 2013) at 16-17, available at <http://www.gao.gov/assets/660/659211.pdf>.
34. GAO, Report to Congressional Requesters, Private Pensions, Better Agency Coordination Could Help Small Employers Address Challenges to Plan Sponsorship, GAO-12-326 (Mar. 2012) at 18-20, available at <http://www.gao.gov/assets/590/589055.pdf> (GAO 2012 Report). Defined benefit, defined contribution and SEP IRA plans are subject to the top-heavy rules. SIMPLE IRA plans and some safe harbor 401(k) plans are exempt under 26 U.S.C. §§ 416(g)(4)(G) and (H).
35. 26 U.S.C. §§ 408(k) and (p).
36. Following significant research, the SPARK Institute, Inc. published a proposal for a Simplified Small Retirement Plan. See SPARK Institute, Inc., Simplified Small Retirement Plan (Mar. 2013), available at [http://www.sparkinstitute.org/content-files/ssrp\\_2013\\_final\\_brochure\\_3-19-13\\_clean.pdf](http://www.sparkinstitute.org/content-files/ssrp_2013_final_brochure_3-19-13_clean.pdf).
37. GAO 2012 Report at 33.
38. IB 2015-02 at 9-10. The DoL clarified that states could establish a prototype plan that small employers could adopt, which may help alleviate some of the administrative burdens with establishing plans. However, since these prototype plans are already generally available in the marketplace, the fact that they are sponsored by a state may not provide a meaningful incentive for small employers to adopt the plan.
39. 29 U.S.C. § 1144(a).
40. Joint Interim Task Force on Oregon Retirement Savings (HB 3436) (Jun. 10, 2014).
41. State of Connecticut, Retirement Security Board, Staff Report to CRSB Re: Conversation with U.S. Department of Labor Staff, available at [http://www.osc.ct.gov/crsb/docs/07\\_01\\_15/StaffReport\\_Jul0115\\_DOLConversation.pdf](http://www.osc.ct.gov/crsb/docs/07_01_15/StaffReport_Jul0115_DOLConversation.pdf) (Connecticut Retirement Security Board Staff Report).
42. Connecticut Retirement Security Board Staff Report; ThinkAdvisor, DoL Advances State-Based Retirement Plan Rule (Sep. 3, 2015), available at <http://www.thinkadvisor.com/2015/09/03/dol-advances-state-based-retirement-plan-rule/>: "The president's fiscal 2016 budget proposal set aside \$6.5 million in funding for DOL, along with waiver authority, to support state efforts to implement state-based automatic enrollment IRAs or 401(k)-type programs."
43. President Obama's Remarks at White House Conference on Aging. See also, DoL Secretary Perez, DoL Blog (Jul. 13, 2015), available at <https://blog.dol.gov/2015/07/13/clearing-a-path-for-state-based-retirement-plans/> ("Time and again, President Obama has proposed legislation that would automatically enroll new workers in an IRA if they lack access to a 401(k)-type plan through their employer. And time and again, Congress has failed to act. If the federal government can't move the needle, then we have to do everything possible to encourage innovation that's already happening at the state level.")
44. President Obama's Remarks at White House Conference on Aging.
45. DoL State-IRA Proposal at 28.
46. Although states, including California and Oregon, may desire to guaranty a particular minimum benefit, purchasing insurance or otherwise providing a guarantee would likely significantly increase cost and complexity, particularly with respect to portability. If programs are successful, the feature of a guaranteed return of principal or income can be introduced at a later date.
47. Treasury Explanation of FY 2016 Revenue Proposals at 134 ("In 401(k) plans, automatic enrollment has tended to increase participation rates to more than nine out of ten eligible employees. In contrast, for workers who lack access to a retirement plan at their workplace and are eligible to engage in tax-favored retirement saving by taking the initiative and making the decisions required to establish and contribute to an IRA, the IRA participation rate tends to be less than one out of ten"); J. Mark Iwry and David C. John, The Retirement Security Project, Pursuing Universal Retirement Security Through Automatic IRAs, 2009-03 (2009) at 6, available at [http://www.brookings.edu/~media/research/files/papers/2009/7/automatic-ira-iwry/07\\_automatic\\_ira\\_iwry.pdf](http://www.brookings.edu/~media/research/files/papers/2009/7/automatic-ira-iwry/07_automatic_ira_iwry.pdf) (The Retirement Security Project Report). This report shows that take-up rate for IRAs is 1 out of 10 and 9 out of 10 for participation in a 401(k) with automatic enrollment. See also Bipartisan Policy Center, "Rethinking Retirement Plans", Statement of James Smith (Oct. 21, 2015), available at <http://bipartisanpolicy.org/events/rethinking-retirement-plans/>. James Smith notes that auto-enrollment has been a "game changer" resulting in higher contribution levels and increased financial awareness.
48. Notice of Proposed Rulemaking - Default Investment Alternatives under Participant Directed Individual Account Plans, 71 Fed. Reg. 56806, 56807 (Sep. 27, 2006).
49. Based on a study of 11.7 million participants in Fidelity-administered plans, plans that offer auto enrollment grew from 2% to 21% in the five years following passage of the PPA. In plans with auto-enrollment, the participation rate for eligible employees in plans jumped to 82%. For plans without auto-enrollment, the participation rate for eligible employees is 55%. This effect is particularly powerful on younger, eligible employees age 20 to 24 where the participation rate is 76% in plans with auto enrollment but only 20% in those plans without it. See Stephen Miller, Society for Human Resource Management, "On PPA's 5th Anniversary, Impact on 401(k) Plans Proves Significant" (Dec. 19, 2011), available at: <http://www.shrm.org/hrdisciplines/benefits/articles/pages/ppaimpact.aspx>.
50. See Kirsten Grind, Wall Street Journal, Companies to Workers: Start Saving More – Or We'll Do It for You (Oct. 15, 2015), available at <http://www.wsj.com/articles/companies-to-workers-start-saving-more-or-well-do-it-for-you-1444901580?alg=y&mg=id-wsj>; H.R. 1735, National Defense Authorization Act for Fiscal Year 2016, available at <https://www.congress.gov/114/bills/hr1735/BILLS-114hr1735enr.pdf>.
51. September 2015 GAO Retirement Security Report at 32 ("Initial opt-out rates have been lower than expected, and U.K. experience has shown the value of harnessing inertia to improve outcomes for workers").
52. September 2015 GAO Retirement Security Report at 26 ("A government study published in March 2015 found that since implementation of reforms began in October 2012, stakeholders perceived them as successful to date. The government reported that by the end of 2014 more than 5 million workers had been automatically enrolled and only 12 percent of workers had opted out in 2014").
53. Id. at 31-32.
54. Id. at 82.
55. Parliamentary Counsel Office of New Zealand, KiwiSaver Act 2006, reprint as of Jun. 1, 2015, available at <http://www.legislation.govt.nz/act/public/2006/0040/latest/whole.html#DLM378380>; SuperLife, KiwiSaver – A General Guide for Employers (Jun. 2015), Appendix C, available at <http://www.superlife.co.nz/files/attachments/Resources%20for%20employers/KiwiSaver%20Employers%20Guide.pdf>.
56. The Retirement Security Project Report at 6.

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