

# How Tax Reform for Retirement Plans Can Affect Risk and Compliance

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By Marcia S. Wagner, Esq.

Current legislative proposals relating to retirement benefits can be grouped into three categories: (i) those whose goals are purely fiscal, (ii) those seeking to expand the current system by adding programs or features that will increase access to it or enhance its fairness and (iii) those that would make the system more efficient by updating rules effectuating obsolete or conflicting policies. It is likely that tax reform will influence the retirement benefits industry in ways large and small just as much as direct attempts at systemic transformation. In this article we will examine both types of change. Any such proposals must balance the goals of increasing revenue and limiting expenditures with maintaining a retirement benefits system that provides effective incentives to save for retirement without undue administrative complexity.

## I. Deficit Reduction Proposals

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*How Plans Affect the Deficit.* Legislators and policymakers know that the amount of tax revenue forgone on account of retirement plans is very large and this makes 401(k) plans an easy target for revenue raising initiatives. In the 2015 Budget of the United States, the Office of Management and Budget projected that foregone revenue attributable to defined contribution plans (a category including 401(k) and similar plans, such as 403(b) plans) for the period 2015-2019 will be \$414 billion. Defined benefit plans and individual retirement accounts (“IRAs”) are expected to add \$333 billion to this amount.

Saving for retirement through a 401(k) plan is tax-advantaged because the government generally taxes neither the original plan contributions nor the investment returns on those contributions until they are paid as benefits. Since the budget process looks at revenues and expenditures within a ten-year window, and the payment of most retirement benefits occurs outside that window, the amount of taxes foregone because of 401(k) contributions tends to be viewed as a permanent expenditure. As pressure has increased to control the federal deficit, legislative proposals incorporate ways to reduce the tax cost of the retirement plan expenditure as a matter of course.



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*Tax Code Contribution Limits.* Employer contributions to 401(k) and other qualified retirement plans are deductible by the employer when made but, as noted above, are not taxable to a plan participant until benefits (including any investment earnings on contributions) are distributed, at which time these amounts are generally subject to ordinary income tax. Similarly, employee elective deferrals and the earnings thereon escape taxation until distribution. The Code places limits on such contributions and on benefits payable by defined benefit plans.

A simple way to achieve deficit reduction is to adjust existing tax code rules that limit plan contributions from their 2014 levels for the purpose of reducing tax expenditures and raising revenue. For example, in the case of 401(k) plans and other defined contribution plans, the maximum amount of annual contributions for any employee from all such plans is \$52,000, and the limit increases to \$57,500 if the employee is at least 50 years old. The limit on annual contributions includes elective deferrals by participants which themselves are capped at \$17,500, unless the participant has attained age 50 in which case this limit is \$23,000. Another limitation subject to being reduced by legislation is the cap on the plan sponsor's deduction for contributions to a 401(k) plan equal to 25% of the compensation otherwise paid during the taxable year to the plan's participants. Further, compensation

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in excess of \$260,000 cannot be considered in calculating contributions to a participant's plan account.

*2014 Tax Reform Act.* Over the years, Congress has raised or lowered these amounts depending on the needs of the time. For example, the last major tax reform effort in 1986 reduced elective deferrals from \$30,000 to \$7,000. A draft tax reform plan released in February 2014 by Dave Camp, chairman of the House Ways and Means Committee, is less drastic and merely freezes the various limits that apply to defined contribution plans until 2024 at which time they would be allowed to rise in accordance with cost of living increases. It is estimated that this restriction would raise \$63.4 billion in revenue over 10 years.

Under the Camp proposal, there would be a further change to the annual \$17,500/\$23,000 ceilings on elective deferrals under which only half of the contribution (\$8,750/\$11,500) could be made on a pre-tax-basis, with the remainder being deferred as Roth contributions. Since Roth contributions are made on an after-tax basis, this proposal would raise an additional \$144 billion in revenue over 10 years by forcing some plan participants to pay higher taxes up-front. However, it is not clear if this figure takes into account the fact that when a Roth account is distributed, investment earnings will escape taxation, thereby decreasing tax revenue. As a result, some speculate that this change will lose revenues in the long run.

Since the Camp proposal's limitation on pre-tax contributions would only apply to employers with more than 100 employees, if it is enacted, compliance professionals will need to be aware that the size of the workforce will control the characterization of an account and determine when it will become necessary to separately track after-tax as well as pre-tax contributions. Arrangements will also be needed to preserve an account's tax attributes when it is rolled over to another plan or to an IRA.

*Administration Proposals.* The Obama administration's recent revenue proposals have put a new spin on the technique of regulating contribution limits by seeking to cap the aggregate accumulation in all tax-favored retirement plans benefitting an individual at the annually adjusted amount of \$3.2 million. This limit is designed to provide an annual lifetime annuity of no more than \$210,000 for a 62 year old plan participant, so that it will vary with age, as well as contributions and investment performance. Plan sponsors and IRA trustees would be expected to report account bal-

ances and contributions at the end of the year to enable the IRS to keep tabs on those making excess contributions which would entail calculations to convert plan account balances into the form of an actuarially equivalent annuity. Taxpayers would be forced to withdraw any excess contributions or pay income tax on the excess amount both in the year contributed and when later distributed. This, of course, would require additional recordkeeping to enable compliance.

In addition to the proposed limit on the overall size of tax-favored retirement accounts discussed above, the Obama Administration's recent budgets also take aim at the 401(k) tax expenditure indirectly through a general tightening of rules relating to tax deductions. This proposal limits the tax

value of particular tax deductions and exclusions to 28% of the specified item's amount that would otherwise reduce taxable income subject to the highest tax bracket of 39.6%. This is not an entirely new concept and a similar provision was included in Representative Camp's 2014 Tax Reform Act proposal. The unprecedented aspect of these proposals is the inclusion of employer and employee 401(k) contributions (as well as health care contributions) on the list of affected tax exclusions. Thus, a taxpayer subject to the top statutory rate of 39.6% would pay an 11.6% tax (39.6% - 28%) on the value of any 401(k) contributions. Under this regime, a participant could potentially be subject to as much as an additional \$6,670 in tax liability. When originally proposed in the 2013 budget, critics pointed out that this restriction results in double taxation, because the same plan contributions would be taxed again when withdrawn from the plan. The latest versions of the proposal address this by adjusting a taxpayer's basis in the retirement plan or IRA to reflect the additional tax imposed.

If 401(k) plans are made less attractive for high income plan participants by the limit on deductions, it can be expected that Roth options forgoing an immediate tax deduction, but permanently insulating investment earnings from taxation, will come into wider use by this group. In this event, plans will be pressured to offer Roth accounts if they do not do so already. It is interesting to note that the 2014 Tax Reform Act sponsored by Representative Camp would require 401(k) Roth accounts and repeal the income eligibility limits for Roth IRAs.

*20/20 Proposal.* Another example of a reform proposal driven by purely fiscal concerns is illustrated by the December 2010 report of the National Commission on Fiscal Responsibility and Reform that would also change the ceiling on plan contributions. The Commission recommended limiting the maximum excludable contribution to a defined contribution plan to the lesser of \$20,000 or 20% of income. This proposal, which covers the exclusion from taxable income of employee elective deferrals, as well as nontaxable employer contributions, is sometimes referred to as the "20/20 cap." Under this formula, if a plan participant earns \$100,000 per year, the most that can be put into his 401(k) account is \$20,000. The 20/20 Cap is hard on high earners who tend to be the decision-makers in matters such as the establishment or continued maintenance of tax-qualified retirement plans. This has led to criticism that implementation of the 20/20 cap would discourage the formation of new plans or even cause the termination of existing plans.

*Brookings Proposal.* Some tax reform proposals are motivated by policy concerns as well as by deficit reduction. William Gale of the Brookings Institution has designed a much-discussed mechanism to shift the demographics of those receiving the benefits of the retirement plan tax expenditure from a perceived slant favoring highly compensated employees. Advocates of this approach generally argue that all employer and employee contributions should be included in gross income and couple this with suggestions as to ways in which the increased tax revenue should be used. The Brookings plan includes a proposal that existing deductions and exclusions be replaced with a flat-rate refundable tax credit to be deposited directly into a plan participant's retirement savings account. Under this proposal, contribution limits would not change. However, given that the refundable tax credit would not be dependent on graduated tax rates, as is the current exclusion or deduction for plan contributions, the credit would benefit low earners at the expense of the more highly compensated. As in the case of the 20/20 cap, critics have noted that this would seriously diminish the incentive employers have to maintain qualified plans.

## II. Increasing Retirement Plan Access

*Retirement Plan Coverage.* The proportion of U.S. workers participating in employer-sponsored retirement plans constitutes just under half the workforce, and among employees eligible to participate in programs such as 401(k) plans, participation rates have ranged from two-thirds to three-quarters of those eligible. For the portion of the workforce that lacks access to employer-sponsored plans (said to be 75 million by their advocates) and for which IRAs are the only available option for retirement saving, the IRA participation rate is less than 10 percent. These facts frustrate policymakers concerned about an aging population's readiness for retirement, leading some to seek a solution in mandatory retirement savings programs that utilize employer payroll systems and automatic enrollment features to overcome employee inertia. There is a broad consensus on the need to increase retirement plan coverage, although not necessarily by these means.

*Automatic IRA Proposal.* The Obama Administration has included an automatic IRA provision in its budget message for the last four years. For this reason, the proposal has become associated with the Democratic Party, obscuring the fact that, as recently as 2007, an earlier auto-IRA bill had been introduced in Congress by representatives of both political

parties after being jointly developed by conservative and liberal think-tanks. If the current proposal were to be enacted, regular contributions would be made to an IRA on a payroll deduction basis at a default rate of 3% of compensation for any employee who fails to provide a written election to either participate in the program or opt out.

The Administration's automatic IRA would be mandatory for all employers with at least 10 employees if the employer does not maintain a qualified plan for its employees. If a plan is maintained but excludes a portion of the workforce from eligibility (*e.g.*, employees of a subsidiary or division), the employer would be required to offer the automatic IRA to the excluded class. While some plan exclusions would be allowed (*e.g.*, collectively bargained employees, those under age 18 and nonresident aliens), many employers whose plans contain other exclusions will need to modify their qualified plans or have an automatic IRA plan in addition to the qualified plan.

The Administration's automatic IRA proposal entails a number of choices that have implications for recordkeeping and compliance. Thus, the proposal would allow employees to raise or lower their contribution percentage relative to the 3% of compensation default or they could choose to opt out entirely. These contributions would be made to either a

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traditional pre-tax IRA or Roth IRA. If an employee fails to choose between these two forms of IRA, however, post-tax Roth accounts would be the default vehicle, so that withdrawals would not be taxable. This default rule addresses the likelihood that lower-income workers would be more likely to withdraw money before age 59½ and otherwise incur an early withdrawal penalty on the taxable amount. The automatic IRA provider (a financial services firm serving as trustee or custodian) could be selected by the employer or the employer could allow each participating employee to designate the IRA

provider. Another alternative would be to forward all contributions to a savings vehicle specified by statute or regulation.

Despite consensus on the need for greater savings, the automatic IRA proposal has elements that are problematic at either end of the political spectrum. Even though no employer contributions would be required, Republicans dislike the employer mandate, since it would require small businesses to offer automatic IRAs and be burdensome to employers. The prospect of a savings vehicle controlled by the Federal government has also been a point of controversy. To counter these reservations, the Administration has designed the proposal so that it involves no employer contributions or need to comply with qualified plan type rules. Employees (not the employer) would be responsible for determining their IRA eligibility and investment options would be limited so as to minimize fiduciary responsibility for managing assets.

On the other side of the political divide, some Democrats are lukewarm with respect to the private sector's potential role in managing automatic IRA money. At the moment, the prospect for legislative action on this initiative is complicated by the high level of Congressional partisanship and policy gridlock which can be expected to continue in the short term. However, it should not be overlooked that Congress

has traditionally dealt with retirement issues on a bipartisan basis and that, given its history, compromise may eventually be reached on the automatic IRA proposal.

*Senator Harkin's USA Retirement Funds Act.* To help prepare workers for retirement, Senator Tom Harkin has proposed the USA Retirement Funds Act establishing a new universal retirement system built around the following principles: (i) automatic enrollment, (ii) a regular stream of income starting at retirement age, (iii)

financing through an employer's payroll system consisting of employee deferrals and voluntary employer contributions, and (iv) management by privately-run, licensed and regulated entities established pursuant to the legislation.

The lifetime annuities to be paid under the new system would be based on the total contributions to a participant's account supplemented by investment performance and government credits for low-wage earners. Up to \$10,000 per year of participant contributions would be automatically made at the rate of 3% of compensation in 2015 escalating to 6% by 2017. While

participants would be allowed, at any time, to decrease contributions or to opt out of the system entirely, such an election would be effective for no more than two years, so that employers would need to resume the maximum level of employee deferrals at the end of such period. It is not clear whether the expiration date for an opt out would necessarily be different for each employee, and if the USA Retirement Funds Act or similar legislation were to be adopted, compliance personnel should be alert for possible guidance or tactics that, in the event an employee has opted out, might permit the reinstatement of automatic contributions on a limited number of dates during the year.

Like the automatic IRA initiative, the Harkin proposal is intended to appeal to employers by relieving them of any fiduciary responsibility, although it does entail administrative burdens, such as annual notification of employees and deadlines for depositing contributions. Moreover, employer participation would be mandatory if the employer has 10 or more employees and does not already offer a plan with a 6% level of employee contributions and a lifetime income option. Very few employer-sponsored plans offer both of these features which means that many of these plans would need to be amended if an employer wished to avoid the mandate of the USA Retirement Funds system.

The Harkin initiative bears a similarity to current proposals being considered by state legislatures under which state governments would sponsor hybrid defined benefit-type plans covering private-sector workers, except that the new managing entities, dubbed “USA Retirement Funds”, take on the role of the state government in managing investments.

*NCPERS Proposal.* The National Conference on Public Employee Retirement Systems (“NCPERS”), a trade organization for public sector pension funds, has proposed amending ERISA and state laws to allow the establishment of state-administered multiple employer cash balance plans covering private-sector workers. The NCPERS proposal, or variations of it, is being considered by several state legislatures. The target group that this proposal seeks to benefit consists of employees of small employers that do not have access to a pension plan through their employer. The assumption is that they would benefit from a state’s bargaining power, experience and expertise. Notwithstanding the substantial role of government in such a plan’s operation, however, it would be structured as a multiple employer plan with respect to which there would be voluntary employer participation and employer contributions. This means that the plan would be subject to ERISA, including the fiduciary duties, minimum

funding requirements and reporting it imposes on sponsoring employers.<sup>1</sup> As ERISA is currently written, responsibility for these requirements cannot be fully transferred to third parties, such as a state. Thus, employers would have residual liability for any compliance failures committed by state administrators of a plan established as proposed by the NCPERS.

The NCPERS Secure Choice Pension (“SCP”) initiative is a bolder variation of prior proposals for state-run plans (involving voluntary contributions to defined contribution plans) in that it entails a defined benefit plan design under which a periodic fixed benefit would be paid for life. This benefit would be determined by applying actuarial conversion factors to the value, as of retirement, of a hypothetical account maintained for each participant. This account would consist of annual employer and/or employee contributions equal to 6% of compensation plus minimum interest credits of 3% per year, regardless of actual investment earnings. Interest credits equal to a rate determined by the yield on 10 year Treasury Bills plus 2% would be made if this rate exceeded 3%.

Although the benefit generated by salary credits would be funded by actual contributions, funding of the benefit attributable to the interest credit would be dependent on investment performance, thereby raising the possibility of funding shortfalls. The assets of an SCP plan would generally be invested in tandem with the assets of the state’s retirement system. Funding issues could be exacerbated by the SCP’s actuarial assumption of 7% investment returns, a figure close to the standard 8% assumption that has created problems for state retirement programs. The funding problem arises, because a higher interest rate assumption justifies larger benefits in relation to level funding. In addition to investment risks, the guaranteed lifetime benefit of an SCP plan would expose the plan to longevity risk if participants were to live longer than assumed under its mortality assumptions. This, in turn, would lead to additional funding issues.

The possibility of inadequate funding is a major weakness of the SCP proposal which would be addressed by tactics, such as reducing purportedly guaranteed benefits, prospectively adjusting interest crediting rates and amortizing unfunded liabilities over 20 years.<sup>2</sup> The latter would seem to have the potential to shift the burden of underfunding to a new generation of employees who would not have benefitted from assuming this obligation. Although employer participation would be voluntary, withdrawal liability could be assessed on terminating employers, as under a multiemployer plan,

thereby making it difficult to leave. If withdrawals do occur, the continuing deficit would pass to the remaining employers and, ultimately to the state and its taxpayers. Proposing that taxpayers underwrite the retirement benefits of private sector employees at a time when state retirement systems are struggling would seem to make state enactment of the SCP proposal in its current defined benefit form unrealistic.

*California Secure Choice.* In September 2012, the California legislature took the first steps to authorize an automatic IRA program to be administered by the state having certain similarities to the NCPERS proposal. Under the California version, employers with 5 or more employees and no other retirement plan will be required to participate, and their employees will be automatically enrolled and contribute 3% of pay through the employer's payroll system unless they opt out. However, no employer contributions will be permitted, primarily because of the fear that this would create an ERISA plan and subject contributing employers to ERISA responsibilities.<sup>3</sup>

Like the NCPERS proposal, the California Secure Choice program will provide a guaranteed investment return but this must be achieved by restricting the level of equity investments, investing in U.S. Treasury securities and purchasing private insurance. The program will not be authorized to move forward unless a feasibility study indicates that it will be completely self-sustaining and involve no public funding.<sup>4</sup>

Employee contributions under California Secure Choice will be pooled and invested by investment managers selected by a state board in accordance with a bidding process in which the California Public Employees' Retirement System will be allowed to participate. Implementation of the program is further conditioned on receiving an IRS ruling that contributions will be pre-tax and Department of Labor approval that the program is not an ERISA plan. Further authorization by the California legislature will also be required which has the potential to result in modifications harmful to employer interests, such as permissive or required matching contributions which, as noted, could trigger the need to comply with various ERISA requirements. This California initiative is important, because, if successful, it will be used as a model by other states.

*Attempts to Expand Access by Other States.* In 2012, the Massachusetts legislature authorized the state treasurer to create a multiple employer defined contribution plan that will receive contributions from non-profit employers employing fewer than 20 persons as well as from their employees. The Massachusetts legislation requires the state treasurer to obtain IRS approval of

the plan and to ensure that it complies with ERISA. Since this program provides for individual accounts over which participants will have the power to direct investments, it would not entail the actuarial and investment risks underlying the NCPERS proposal but it could constitute an ERISA plan. The Indiana legislature is currently considering a proposal similar to the Massachusetts legislation. A number of other states have also considered pension legislation for private-sector employees, although in some cases such proposals only authorize study of the matter.<sup>5</sup>

*Expanding Access through Private-Sector Plans.* The Safe Retirement Act of 2013 proposed by U. S. Senator Orrin Hatch attempts to address the need for expanded access to retirement savings programs by creating a new type of private-sector plan aimed at encouraging plan adoption by small or start-up businesses that cannot afford employer contributions or the administrative costs of a 401(k) plan. In contrast to other proposals that would pool funds, guarantee investment returns and limit payout to periodic lifetime payments, Senator Hatch's idea is to authorize a retirement savings vehicle, called "Starter 401(k)s", with individual accounts controlled by participants who would be able to contribute up to \$8,000 annually without the burden of discrimination testing. There would be no required employer contributions and reduced administrative burdens in order to minimize the plan's cost. To encourage employees to participate, automatic deferrals could range from 3% to 15% of compensation, subject to a participant's opting out).

As an alternative to the government mandate of other proposals, Senator Hatch's plan would provide employers with an incentive to establish a Starter 401(k) by increasing the tax credit for adopting a new qualified plan from \$500 to an amount up to \$5,000 assuming the plan covers at least 20 non-highly compensated employees (*i.e.*, \$250 for each such participant). The credit can apply for up to 3 years.

### III. Proposals to Improve Efficiency

*SAFE Retirement Act.* Every year numerous proposals are made to amend the Internal Revenue Code in order to build on the current employer-based private retirement system. The SAFE Retirement Act, filed by Senator Hatch in July 2013 and discussed above in connection with proposals to expand access to the system, also includes a comprehensive set of provisions designed to simplify plan administration. For example, the bill contains several liberalizing provisions that would make it easier to elect safe harbor status for a 401(k) plan, thereby

allowing the plan to avoid nondiscrimination testing. Thus, a new rule would permit an employer to delay the election of safe harbor status and the related notice to employees of such status until the last day of the first safe harbor plan year. Another provision would allow amendments to a safe harbor

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plan to be adopted during the plan year as long as the amendment does not cause a violation of safe harbor requirements.

The SAFE Retirement Act also repeals unnecessary administrative burdens such as the testing of so-called top heavy plans (plans having a higher concentration of accrued benefits for key employees) made unnecessary by other nondiscrimination tests. Simplified rules are also provided for plan amendments, discrimination testing, hardship distributions, rollovers, notice requirements and plan terminations. Also noteworthy is a provision directing the IRS and Department of Labor to allow consolidation of various notices to employees into a single notice and to provide flexibility as to the time when such notice must be furnished. Many of these provisions, which make 401(k) and other retirement plans more attractive or less burdensome, are likely to find their way into other legislative proposals.<sup>6</sup>

*Tax Reform Act of 2014.* Representative Camp's proposed wholesale revision of the tax code also includes numerous provisions affecting retirement plans but is a much broader undertaking with a greater focus on revenue than enabling the retirement system to run more smoothly. Thus, while there are changes that would make it easier to comply with rules relating to hardship distributions, rollovers and early withdrawals, the minimum distribution requirement for IRAs and employer-sponsored plans would be modified to ensure distribution within five years of an IRA owner's or plan participant's death in order to limit the tax deferral of IRA or plan proceeds and increase revenues by \$3.5 billion over ten years.

The focus on revenue dovetails with Representative Camp's desire to enhance the role of Roth IRAs and Roth 401(k) accounts, contributions to which are not excluded from taxable income. The Tax Reform Act of 2014 would eliminate new contributions to traditional IRAs and require that all future

IRA contributions be made to Roth IRAs. In a similar vein, 401(k) plans would be required to offer Roth accounts and at least half of a participant's plan contributions would need to be made as Roth contributions. In addition, as previously noted, income eligibility limitations on making Roth contributions would be lifted. The discussion draft summarizing the Camp proposals indicates the drafters' view that most people do not consider the taxes that will be due upon distribution of traditional benefits and mistakenly assume that the entire account balance will be available upon retirement.

The policy underlying the Roth enhancements is that since the entire balance in a Roth account will be available for retirement needs, given that it is distributed free of tax, the changes will promote retirement security by increasing the amounts that retirees may actually spend.

#### **IV. Summing Up**

The private pension system is under pressure and may be significantly transformed either through tax reform seeking additional revenue or through more direct efforts to transform the character of the system to include one or more of the following elements: (i) mandatory employer and/or employee contributions, (ii) pooling of contributions for investment purposes or government control over the investment provider, (iii) guaranteed investment returns and (iv) limited withdrawal rights and required distribution in the form of lifetime income options.

Current tax incentives encourage employers to offer retirement plans on a voluntary basis and motivate individuals to save for retirement. If this support is cut back under the 20/20 proposal or similar initiatives, the result will likely be reductions in 401(k) balances at all levels of the income spectrum, given that tax incentives are important for both low wage earners and higher paid employees. However, continued employer participation in a smaller retirement benefits system will present the same compliance burdens and level of risk as under the presently constituted system. The same can be said if there is a shift to after-tax contributions due to the enhancement of Roth accounts as proposed by the Tax Reform Act of 2014, except for the recordkeeping and reporting complexities of tracking earnings of and distributions from both pre-tax and after-tax accounts.

Advocates of centralization who distrust financial markets recognize the deficit reduction debate as a rare opportunity to enlarge the role of government in the retirement benefits arena with the ultimate goal of eliminating the role of employers, except as a source of funding. The issue is often framed as one of providing access to retirement savings vehicles by low-paid workers of small employers, which is a laudable goal, although these employees have always had the ability to establish IRAs on their own. Automatic IRAs, as proposed by the Obama administration or increases in the level of automatic contributions under 401(k) plans and Starter 401(k)s established under Senator Hatch's SAFE Retirement Act would deal with the obstacle of employee inertia but otherwise stay within the current system.

Various proposals at the state and federal level would authorize high levels of automatic employee contributions, mandate employer contributions, pool investments, provide guaranteed investment returns and distribute fixed benefits for life, while

leaving responsibility for funding shortfalls unclear. Creating such entitlements may result in the formation of interest groups capable of lobbying for benefit enhancements in good times and resisting cutbacks in bad, even if the benefit adjustments were permitted under ERISA. Employers could be required to assume new fiduciary, investment and mortality risks under these systems, since they purport to be employer plans.

The state-backed initiatives raise an additional problem in that a multitude of state-administered retirement programs covering private-sector workers, each with its own unique rules that have been excepted from ERISA, would have the potential to break down the nationwide uniformity in pension laws that was achieved by the enactment of ERISA in 1974. To the extent that they remain subject to ERISA's fiduciary standards, state-backed programs will need to be careful to determine what fiduciary responsibility remains with employers.

ENDNOTES

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<sup>1</sup> Governmental plans are exempt from ERISA, including its fiduciary duties, by virtue of an exception under ERISA Section 4(b). However, Section 3(32) of ERISA limits the definition of a governmental plan to a plan established or

maintained for its [*i.e.*, government] employees by the government of a state or political subdivision thereof, making it clear that coverage of private-sector employees would cause a plan to fall outside the governmental plan exception. In Advisory Opinion 2012-01A, the Department of Labor addressed the consequences of participation by private-sector employees in a group health plan established by the State of Connecticut for state employees. The opinion concluded that a plan claiming governmental plan status would not be permitted to allow participation by more than a de minimis number of private-sector workers. Prior Department opinions indicate that this principle also applies to retirement plans. See Advisory Opinion 99-07A.

<sup>2</sup> Cutting back benefits may not be realistic given the SCP's implicit promise that the state sponsor will back them. In addition, unless there is amending legislation, adjusting benefits that have already accrued would appear to violate ERISA anti-cutback rule.

<sup>3</sup> Rather than rely on ERISA's governmental plan exception, the California program apparently seeks to avoid ERISA by qualifying for an exception from the definition of a "pension plan" that is available to certain IRAs under ERISA Regulation Section 2510.3-2(d). To come within this exception, an IRA program must meet the following conditions: (i) no contributions may be made by the employer, (ii) participation must be "completely voluntary" for employees (throwing into question

the practice of automatic enrollment) and (iii) the employer's involvement in the program can be no more than allowing the use of its payroll system to collect contributions.

<sup>4</sup> The feasibility study is expected to be completed in 2014.

<sup>5</sup> According to the National Conference of State Legislatures, Connecticut, Illinois, Maryland, Michigan, New York, Pennsylvania, Rhode Island, Washington State, Vermont, Virginia, and West Virginia have investigated public-private partnership to extend opportunities for retirement savings. See <http://www.ncsl.org/research/labor-and-employment/state-sponsored-retirement-plans-for-nonpublic.aspx>.

<sup>6</sup> Senator Hatch's proposal is also notable for a measure designed to shore-up insolvent public retirement systems. If enacted, state and local governments would be able to adopt a so-called SAFE Retirement Plan which would annually purchase a deferred fixed income annuity contract (under which benefits would generally commence at age 67) from an insurer for each plan participant with the government employer's annual contribution on the participant's behalf. This would eliminate underfunding, at least on an ongoing basis, while enhancing public pension security and transferring investment risk to the insurers. A controversial by-product of the SAFE Retirement Plan, however, would be its conversion of final average pay plans, the prevailing form of public plan, into career average plans that tend to result in smaller benefits.

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