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# DOL Encourages State-Run Retirement Programs

Following the Obama Administration's directive, DOL issued guidance on the application of ERISA to state-run retirement savings programs. A proposed safe harbor describes state-required automatic IRA programs that could avoid ERISA coverage, and an interpretative bulletin articulates DOL's views on other state programs that would be considered ERISA plans. While this guidance is designed to expand access to retirement savings for employees whose private sector employers do not sponsor a retirement plan, it may also be relevant to employers sponsoring plans that do not permit participation by their entire workforce. Comments on the proposed rule are due on January 19, 2016.

## Background

Expanding access to retirement savings has been a longstanding goal of the Obama administration, which estimates that approximately 68 million Americans lack access to an employer-based retirement savings program. (See our February 28, 2014 and January 31, 2014 *Legislate* publications for a description of President Obama's auto-IRA proposal and "myRA" savings initiative.)

Meanwhile, this access concern has led some states to enact or consider enacting savings programs. Under the "auto-IRA" approach, now law in California, Illinois, and Oregon, the state establishes a payroll savings program and employers deduct amounts selected by employees from their paychecks to remit to state-administered IRAs. Washington State, for its part, has adopted a marketplace approach where a state program connects small employers of fewer than 100 employees with private sector savings plan providers. And a Massachusetts law enables certain nonprofit organizations with fewer than 20 employees to adopt a prototype plan developed and administered by the state.

According to the Obama administration, the prospect of ERISA preemption has deterred the development, and called into question the viability, of these and other state-run retirement initiatives. As such, at the White

**What is ERISA preemption and why does it matter?**

ERISA's preemption provision declares that (with some important exceptions) ERISA supersedes state laws that "relate to any employee benefit plan." Additionally, courts have held that state and local laws that "conflict with" ERISA's substantive provisions are preempted — meaning, invalid. For employers operating in more than one state, or with employees residing in more than one state, ERISA preemption permits streamlined administration of ERISA-governed retirement savings plans.

House Conference on Aging in July 2015, President Obama directed DOL to issue guidance supporting state efforts to broaden retirement access, consistent with federal law.

## Guidance Supports State-Based Programs

On November 18, 2015, the DOL issued a proposed rule along with an interpretive bulletin (IB) aimed at facilitating state-based retirement programs. A fact sheet and news release accompanied this guidance.

### Proposed Safe Harbor Regulation

Designed to give states a roadmap to avoid the application of ERISA, the proposed regulation sets forth circumstances where a state-required payroll deduction savings program would not give rise to an ERISA plan.

Specifically, to meet the safe harbor's requirements, the state must:

- Establish and administer the program under state law, and require certain private sector employers to participate
- Be responsible for investing employee savings, or selecting investment options from which employees can choose — and for the security of payroll deductions and employee savings
- Create and enforce employee notice requirements about participant rights under the program

Participation in the program must be voluntary for employees, meaning that they can opt out of participating. They must also be able to withdraw any portion of their contributions or earnings under Code rules applicable to IRAs generally, without any additional costs or penalties. Rights under the program must be enforceable only by the employee, former employee, or beneficiary (or their authorized representative), or the state.

**Roadmap to Avoid ERISA**

The safe harbor addresses the concern that payroll deduction programs similar to those enacted in California, Oregon and Illinois could cause employers to inadvertently establish ERISA-covered plans, and thereby become subject to ERISA's many statutory and regulatory requirements.

The employer's involvement in the program must be limited. The employer must not contribute funds to the program, or offer a bonus or other incentive to employees in exchange for participation. Additionally, the employer cannot have discretionary authority, control, or responsibility for the program, or receive any payments in connection with the program — other than reimbursement for their actual costs. The employer can, however:

- Collect employee contributions through payroll deductions and remit them to the program
- Notify employees and maintain records about collection and remittance of payments
- Provide the state with information needed for the program
- Distribute program information from the state to employees, and allow the state to publicize the program to employees

The DOL designed the safe harbor to support a court finding that ERISA does not preempt such state programs. However, as DOL Secretary Thomas E. Perez acknowledged, this result is not guaranteed because courts may disagree with DOL's conclusion.

**Comment.** The safe harbor could minimize the risk of ERISA preemption if the court reviewing a state-required automatic IRA program defers to DOL's views on this topic.

### Interpretive Bulletin on State-Based Programs Covered by ERISA

In IB 2015-2, DOL articulated its view that ERISA preemption is not an "insurmountable obstacle" to certain state programs designed to facilitate ERISA-governed voluntary retirement savings sponsored by private sector employers. While recognizing the absence of legal authority directly on point, the IB points to the following approaches DOL believes states could implement consistent with ERISA's rules, protections and remedies:

**State-run marketplaces.** Akin to the Washington state law referred to above, the state connects employers with providers of quality products that are suitable to small employers and charge low fees. Participation in the marketplace is voluntary for employers, and is not itself designed to be an ERISA-covered plan. However, products available through the marketplace can include both ERISA and non-ERISA plans. ERISA requirements would apply only to the ERISA plans and not to arrangements like payroll deduction IRA programs that are otherwise exempt form ERISA coverage.

**State-administered prototype plans.** The state creates and administers prototype plans like those currently available in the private sector, where an individual employer selects particular plan features. An example of this approach is the Massachusetts law that allows nonprofit entities with fewer than 20 employees to adopt a contributory retirement plan developed and administered by the state. Under this model, the employer adopts the prototype plan, serves as plan sponsor, and assumes ERISA fiduciary duties. However, the plan documents could allow the employer to delegate certain fiduciary and administrative duties to other entities, or the documents themselves could designate the state to perform these duties — and then the state or a designated third party could handle most administrative and asset management functions.

**State MEPs.** The state sets up a multiple employer plan (MEP), which certain employers could join by executing a participation agreement. The MEP would be considered a single ERISA plan, with the state serving as the ERISA plan sponsor (though not necessarily the plan sponsor for Code purposes such as deductions and nondiscrimination testing), named fiduciary and plan administrator. Participating employers' fiduciary responsibilities could be limited to prudent selection of the arrangement and monitoring of its operation. Similarly, participating employers' administrative involvement could be limited to enrolling employees and remitting employee and employer contributions to the plan. According to DOL, this approach would allow the state to take advantage of economies of scale to lower administrative and other costs. Additionally, as DOL would consider the MEP a single ERISA plan, there would be only one Form 5500 filing.

**Comment.** In past guidance, e.g., Advisory Opinion 2012-04A, DOL rejected the efforts of unrelated employers to join forces and form a single MEP underwritten or administered by a private sector entity (known as an "open MEP"). DOL's rationale has been that, to sponsor an ERISA plan, an entity must either act directly as the employer of the covered employees or "indirectly in the interest of an employer" in connection with the plan. According to DOL, the administering private sector entity lacks the requisite connection to the employees in the open MEP context. This IB, in contrast, provides that a state's "unique

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representational interest in the health and welfare of its citizens" sufficiently ties it to the contributing employers and their employees such that the state is acting "indirectly in the interest of an employer." Some stakeholders have criticized this aspect of the IB as advantaging state-based MEPs above open MEPs without cogent policy reasons for doing so. Likewise, it is not clear how DOL would view a state law that impacts individuals who are not citizens of that state, but who work within the state or who work for an employer operating within the state.

The IB notes that advantages of a state-run ERISA plan (as compared with a state-run IRA approach that meets the safe harbor's requirements for avoiding ERISA coverage) include greater savings opportunities through employer contributions and higher contribution limits, stronger protection from creditors, and potential tax credits for start-up costs.

## Relevance to Employer Plan Sponsors

This guidance aims to encourage retirement savings for those not covered by a private sector workplace retirement plan. Neither the proposed safe harbor nor the IB affect an employer's ability to sponsor retirement savings plans for its employees, or an employer's rights and obligations concerning those plans.

However, employer-sponsored retirement plans may not cover an employer's entire workforce. For example, many plans feature minimum age and service eligibility requirements that exclude some part-timers, independent contractors and very young employees. A state might require employer participation for employees who do not meet employer-sponsored plan eligibility standards. This requirement could pose compliance and administrative challenges for employers that operate in multiple states. For example, where an employer operates in both State A and State B, with State A mandating coverage for individuals *residing* in State A and State B mandating coverage for individuals *working* in State B, the employer may need to comply with both state laws for the same employee.

## In Closing

It remains to be seen whether DOL weighing in on state-based retirement savings programs will prompt a congressional response. Meanwhile, plan sponsors should consider any employee populations that might be affected by the guidance. Comments on the proposed regulation are due January 19, 2016. Although the IB is not subject to a notice and comment period, some comments on the proposed regulation might include feedback on the IB.

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ENHANCED CONTENT

PUBLISHED DOCUMENT

## AGENCY:

Employee Benefits Security Administration, Labor.

## ACTION:

Interpretive bulletin.

## SUMMARY:

This document sets forth the views of the Department of Labor (Department) concerning the application of the Employee Retirement Income Security Act of 1974 (ERISA) to certain state laws designed to expand the retirement savings options available to private sector workers through ERISA-covered retirement plans. Concern over adverse social and economic consequences of inadequate retirement savings levels has prompted several states to adopt or consider legislation to address this problem. The Department separately released a proposed regulation describing safe-harbor conditions for states and employers to avoid creation of ERISA-covered plans as a result of state laws that require private sector employers to implement in their workplaces state-administered payroll deduction IRA programs (auto-IRA laws). This Interpretive Bulletin does not address such state auto-IRA laws.

## DATES:

This interpretive bulletin is effective on November 18, 2015.

## FOR FURTHER INFORMATION CONTACT:

Office of Regulations and Interpretations, Employee Benefits Security Administration, (202) 693-8500. This is not a toll-free number.

## SUPPLEMENTARY INFORMATION:

In order to provide a concise and ready reference to its interpretations of ERISA, the Department publishes its interpretive bulletins in the Rules and Regulations section of the **Federal Register**. The Department is publishing in this issue of the **Federal Register**, ERISA Interpretive Bulletin 2015-02, which interprets ERISA section 3(2)(A), 29 U.S.C. 1002 (https://api.fdsys.gov/link?collection=uscode&title=29&year=mostrecent§ion=1002&type=usc&link-type=html)(2)(A), section 3(5), 29 U.S.C. 1002 (https://api.fdsys.gov/link?collection=uscode&title=29&year=mostrecent§ion=1002&type=usc&link-type=html)(5), and section 514, 29 U.S.C. 1144 (https://api.fdsys.gov/link?collection=uscode&title=29&year=mostrecent§ion=1144&type=usc&link-type=html), as they apply to state laws designed to expand workers' access to retirement savings programs. Some states have adopted laws or are exploring approaches designed to expand the retirement savings options available to their private sector workers through ERISA-covered retirement plans. One of the challenges the states face in expanding retirement savings opportunities for private sector employees is uncertainty about ERISA preemption of such efforts. ERISA generally would preempt a state law that required employers to establish and maintain ERISA-covered employee benefit pension plans. The Department also has a strong interest in promoting retirement savings by employees. The Department recognizes that some employers currently do not provide pension plans for their employees. The Department believes that it is important that employees of such

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employers be encouraged to save for retirement, and it is in the interest of the public that employers be encouraged to provide opportunities for their employee retirement savings. The Department therefore believes that states, employers, other plan sponsors, workers, and other stakeholders would benefit from guidance on the application of ERISA to these state initiatives.

## List of Subjects in 29 CFR Part 2509 (/select-citation/2015/11/18/29-CFR-2509)

- Employee benefit plans
- Pensions

For the reasons set forth in the preamble, the Department is amending Subchapter A, Part 2509 of Title 29 of the Code of Federal Regulations as follows:

### Subchapter A—General

## PART 2509—INTERPRETIVE BULLETINS RELATING TO THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

**1.** The authority citation for part 2509 continues to read as follows:

**Authority:** 29 U.S.C. 1135 (https://api.fdsys.gov/link?collection=uscode&title=29&year=mostrecent§ion=1135&type=usc&link-type=html). Secretary of Labor's Order No. 1-2011, 77 FR 1088 (/citation/77-FR-1088) (Jan. 9, 2012). Sections 2509.75-10 and 2509.75-2 issued under 29 U.S.C. 1052 (https://api.fdsys.gov/link?collection=uscode&title=29&year=mostrecent§ion=1052&type=usc&link-type=html), 1053, 1054. Sec. 2509.75-5 also issued under 29 U.S.C. 1002 (https://api.fdsys.gov/link?collection=uscode&title=29&year=mostrecent§ion=1002&type=usc&link-type=html). Sec. 2509.95-1 also issued under sec. 625, Public Law 109-280 (https://api.fdsys.gov/link?collection=plaw&congress=109&lawtype=public&lawnum=280&link-type=html), 120 Stat. 780.

**2.** Add § 2509.2015-02 to read as follows:

**§ 2509.2015-02 Interpretive bulletin relating to state savings programs that sponsor or facilitate plans covered by the Employee Retirement Income Security Act of 1974.**

(a) *Scope.* This document sets forth the views of the Department of Labor (Department) concerning the application of the Employee Retirement Income Security Act of 1974 (ERISA) to certain state laws designed to expand the retirement savings options available to private sector workers through ERISA-covered retirement plans. Concern over adverse social and economic consequences of inadequate retirement savings levels has prompted several states to adopt or consider legislation to address this problem.[1] An impediment to state adoption of such measures is uncertainty about the effect of ERISA's broad preemption of state laws that "relate to" private sector employee benefit plans. In the Department's view, ERISA preemption principles leave room for states to sponsor or facilitate ERISA-based retirement savings options for private sector employees, provided employers participate voluntarily and ERISA's requirements, liability provisions, and remedies fully apply to the state programs.

(b) *In General.* There are advantages to utilizing an ERISA plan approach. Employers as well as employees can make contributions to ERISA plans, contribution limits are higher than for other state approaches that involve individual retirement plans (IRAs) that are not intended to be ERISA-covered

plans,[2] and ERISA plan accounts have stronger protection from creditors. Tax credits may also allow small employers to offset part of the costs of starting certain types of retirement plans.[3] Utilizing ERISA plans also provides a well-established uniform regulatory structure with important consumer protections, including fiduciary obligations, automatic enrollment rules, recordkeeping and disclosure requirements, legal accountability provisions, and spousal protections.

The Department is not aware of judicial decisions or other ERISA guidance directly addressing the application of ERISA to state programs that facilitate or sponsor ERISA plans, and, therefore, believes that the states, employers, other plan sponsors, workers, and other stakeholders would benefit from guidance setting forth the general views of the Department on the application of ERISA to these state initiatives. The application of ERISA in an individual case would present novel preemption questions and, if decided by a court, would turn on the particular features of the state-sponsored program at issue, but, as discussed below, the Department believes that neither ERISA section 514 specifically, nor federal preemption generally, are insurmountable obstacles to all state programs that promote retirement saving among private sector workers through the use of ERISA-covered plans.

## Marketplace Approach

One state approach is reflected in the 2015 Washington State Small Business Retirement Savings Marketplace Act.[4] This law requires the state to contract with a private sector entity to establish a program that connects eligible employers with qualifying savings plans available in the private sector market. Only products that the state determines are suited to small employers, provide good quality, and charge low fees would be included in the state's "marketplace." Washington State employers would be free to use the marketplace or not and would not be required to establish any savings plans for their employees. Washington would merely set standards for arrangements marketed through the marketplace. The marketplace arrangement would not itself be an ERISA-covered plan, and the arrangements available to employers through the marketplace could include ERISA-covered plans and other non-ERISA savings arrangements. The state would not itself establish or sponsor any savings arrangement. Rather, the employer using the state marketplace would establish the savings arrangement, whether it is an ERISA-covered employee pension benefit plan or a non-ERISA savings program. ERISA's reporting and disclosure requirements, protective standards and remedies would apply to the ERISA plans established by employers using the marketplace. On the other hand, if the plan or arrangement is of a type that would otherwise be exempt from ERISA (such as a payroll deduction IRA arrangement that satisfies the conditions of the existing safe harbor at 29 CFR 2510.3 (/select-citation/2015/11/18/29-CFR-2510.3)-2(d)), the state's involvement as organizer or facilitator of the marketplace would not by itself cause that arrangement to be covered by ERISA. Similarly, if, as in Washington State, a marketplace includes a type of plan that is subject to special rules under ERISA, such as the SIMPLE-IRA under section 101(h) of ERISA, the state's involvement as organizer or facilitator of the marketplace would not by itself affect the application of the special rules.

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## Prototype Plan Approach

Another potential approach is a state sponsored "prototype plan." At least one state, Massachusetts, has enacted a law to allow nonprofit organizations with fewer than 20 employees to adopt a contributory retirement plan developed and administered by the state.[5] Banks, insurance companies and other regulated financial institutions commonly market prototype plans to employers as simple means for them to establish and administer employee pension benefit plans.[6] The financial institutions develop standard form 401(k) or other tax-favored retirement plans (such as SIMPLE-IRA plans) and secure IRS approval. Typically, employers may choose features such as contribution rates to meet their specific needs. Each employer that adopts the prototype sponsors an ERISA plan for its employees. The

individual employers would assume the same fiduciary obligations associated with sponsorship of any ERISA-covered plans. For example, the prototype plan documents often specify that the employer is the plan's "named fiduciary" and "plan administrator" responsible for complying with ERISA, but they may allow the employer to delegate these responsibilities to others. The plan documents for a state-administered prototype plan could designate the state or a state designee to perform these functions. Thus, the state or a designated third-party could assume responsibility for most administrative and asset management functions of an employer's prototype plan. The state could also designate low-cost investment options and a third-party administrative service provider for its prototype plans.

## Multiple Employer Plan (MEP) Approach

A third approach, (referenced, for example, in the "Report of the Governor's Task Force to Ensure Retirement Security for All Marylanders"),[7] involves a state establishing and obtaining IRS tax qualification for a "multiple employer" 401(k)-type plan, defined benefit plan, or other tax-favored retirement savings program. The Department anticipates that such an approach would generally involve permitting employers that meet specified eligibility criteria to join the state multiple employer plan. The plan documents would provide that the plan is subject to Title I of ERISA and is intended to comply with Internal Revenue Code tax qualification requirements. The plan would have a separate trust holding contributions made by the participating employers, the employer's employees, or both. The state, or a designated governmental agency or instrumentality, would be the plan sponsor under ERISA section 3(16)(B) and the named fiduciary and plan administrator responsible (either directly or through one or more contract agents, which could be private-sector providers) for administering the plan, selecting service providers, communicating with employees, paying benefits, and providing other plan services. A state could take advantage of economies of scale to lower administrative and other costs.

As a state-sponsored multiple employer plan ("state MEP"), this type of arrangement could also reduce overall administrative costs for participating employers in large part because the Department would consider this arrangement as a single ERISA plan. Consequently, only a single Form 5500 Annual Return/Report would be filed for the whole arrangement. In order to participate in the plan, employers simply would be required to execute a participation agreement. Under a state MEP, each employer that chose to participate would not be considered to have established its own ERISA plan, and the state could design its defined contribution MEP so that the participating employers could have limited fiduciary responsibilities (the duty to prudently select the arrangement and to monitor its operation would continue to apply). The continuing involvement by participating employers in the ongoing operation and administration of a 401(k)-type individual account MEP, however, generally could be limited to enrolling employees in the state plan and forwarding voluntary employee and employer contributions to the plan. When an employer joins a carefully structured MEP, the employer is not the "sponsor" of the plan under ERISA, and also would not act as a plan administrator or named fiduciary. Those fiduciary roles, and attendant fiduciary responsibilities, would be assigned to other parties responsible for administration and management of the state MEP.[8] Adoption of a defined benefit plan structure would involve additional funding and other employer obligations.[9]

can also be contracted out to a third party

For a person (other than an employee organization) to sponsor an employee benefit plan under Title I of ERISA, such person must either act directly as the employer of the covered employees or "indirectly in the interest of an employer" in relation to a plan.[10] ERISA sections 3(2), 3(5). A person will be considered to act "indirectly in the interest of an employer, in relation to a plan," if such person is tied to the contributing employers or their employees by genuine economic or representational interests unrelated to the provision of benefits.[11] In the Department's view, a state has a unique representational interest in the health and welfare of its citizens that connects it to the in-state employers that choose to participate in the state MEP and their employees, such that the state should

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be considered to act indirectly in the interest of the participating employers.[12] Having this unique nexus distinguishes the state MEP from other business enterprises that underwrite benefits or provide administrative services to several unrelated employers.[13]

(c) *ERISA Preemption.* The Department is aware that a concern for states adopting an ERISA plan approach is whether or not those state laws will be held preempted. ERISA preemption analysis begins with the "presumption that Congress does not intend to supplant state law." *New York State Conference of Blue Cross & Blue Shield Plans* v. *Travelers Ins. Co.,* 514 U.S. 645, 654 (1995). The question turns on Congress's intent "to avoid a multiplicity of regulation in order to permit nationally uniform administration of employee benefit plans." *Id.* at 654, 657. *See also Fort Halifax Packing Co.* v. *Coyne,* 482 U.S. 1, 11 (1987) (goal of ERISA preemption is to "ensure . . . that the administrative practices of a benefit plan will be governed by only a single set of regulations.").

Section 514 of ERISA provides that Title I "shall supersede any and all State laws insofar as they . . . relate to any employee benefit plan" covered by the statute. The U.S. Supreme Court has held that "[a] law `relates to' an employee benefit plan, in the normal sense of the phrase, if it has a connection with or reference to such a plan." *Shaw* v. *Delta Air Lines, Inc.,* 463 U.S. 85, 96-97 (1983) (footnote omitted); *see, e.g., Travelers,* 514 U.S. at 656. A law has a "reference to" ERISA plans if the law "acts immediately and exclusively upon ERISA plans" or "the existence of ERISA plans is essential to the law's operation." *California Div. of Labor Standards Enforcement* v. *Dillingham Constr., N.A.,* 519 U.S. 316, 325-326 (1997). In determining whether a state law has a "connection with ERISA plans," the U.S. Supreme Court "look[s] both to `the objectives of the ERISA statute as a guide to the scope of the state laws that Congress understood would survive,' as well as to the nature of the effect of the state law on ERISA plans," to "determine whether [the] state law has the forbidden connection" with ERISA plans. *Egelhoff* v. *Egelhoff,* 532 U.S. 141, 147 (2001) (quoting *Dillingham,* 519 U.S. at 325). In various decisions, the Court has concluded that ERISA preempts state laws that: (1) Mandate employee benefit structures or their administration; (2) provide alternative enforcement mechanisms; or (3) bind employers or plan fiduciaries to particular choices or preclude uniform administrative practice, thereby functioning as a regulation of an ERISA plan itself.[14]

In the Department's view, state laws of the sort outlined above interact with ERISA in such a way that section 514 preemption principles and purposes would not appear to come into play in the way they have in past preemption cases. Although the approaches described above involve ERISA plans, they do not appear to undermine ERISA's exclusive regulation of ERISA-covered plans. The approaches do not mandate employee benefit structures or their administration, provide alternative regulatory or enforcement mechanisms, bind employers or plan fiduciaries to particular choices, or preclude uniform administrative practice in any way that would regulate ERISA plans.

Moreover, the approaches appear to contemplate a state acting as a participant in a market rather than as a regulator. The U.S. Supreme Court has found that, when a state or municipality acts as a participant in the market and does so in a narrow and focused manner consistent with the behavior of other market participants, such action does not constitute state regulation. *Compare Building and Construction Trades Council* v. *Associated Builders and Contractors of Massachusetts/Rhode Island, Inc.,* 507 U.S. 218 (1993); *Wisconsin Department of Industry, Labor and Human Relations* v. *Gould,* 475 U.S. 282 (1986); *see also American Trucking Associations, Inc.* v. *City of Los Angeles,* 133 S. Ct. 2096, 2102 (2013) (Section 14501(c)(1) of the Federal Aviation Administration Authorization Act, which preempts a state "law, regulation, or other provision having the force and effect of law related to a price, route, or service of any motor carrier," 49 U.S.C. 14501 (https://api.fdsys.gov/link?collection=uscode&title=49&year=mostrecent§ion=14501&type=usc&link-type=html)(c)(1),

"draws a rough line between a government's exercise of regulatory authority and its own contract-based participation in a market"); *Associated General Contractors of America* v. *Metropolitan Water District of Southern California,* 159 F.3d 1178, 1182-84 (9th Cir. 1998) (recognizing a similar distinction between state regulation and state market participation). By merely offering employers particular ERISA-covered plan options [15] (or non-ERISA plan options), these approaches (whether used separately or together as part of a multi-faceted state initiative) do not dictate how an employer's plan is designed or operated or make offering a plan more costly for employers or employees. Nor do they make it impossible for employers operating across state lines to offer uniform benefits to their employees.[16] Rather than impair federal regulation of employee benefit plans, the state laws would leave the plans wholly subject to ERISA's regulatory requirements and protections.

Of course, a state must implement these approaches without establishing standards inconsistent with ERISA or providing its own regulatory or judicial remedies for conduct governed exclusively by ERISA. ERISA's system of rules and remedies would apply to these arrangements. A contractor retained by a state using the marketplace approach would be subject to the same ERISA standards and remedies that apply to any company offering the same services to employers. Similarly, a prototype plan or multiple employer plan program that a state offers to employers would have to comply with the same ERISA requirements and would have to be subject to the same remedies as any private party offering such products and services.[17]

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Even if the state laws enacted to establish programs of the sort described above "reference" employee benefit plans in a literal sense, they should not be seen as laws that "relate to" ERISA plans in the sense ERISA section 514(a) uses that statutory term because they are completely voluntary from the employer's perspective, the state program would be entirely subject to ERISA, and state law would not impose any outside regulatory requirements beyond ERISA. They do not require employers to establish ERISA-covered plans, forbid any type of plan or restrict employers' choices with respect to benefit structures or their administration. These laws would merely offer a program that employers could accept or reject. *See Dillingham,* 519 U.S. at 325-28.

In addition, none of the state approaches described above resemble the state laws that the Court held preempted in its pre-*Travelers* "reference to" cases. Those laws targeted ERISA plans as a class with affirmative requirements or special exemptions. *See, e.g., District of Columbia* v. *Greater Wash. Bd. of Trade,* 506 U.S. 125, 128, 129-133 (1992) (workers' compensation law that required employee benefits "set by reference to [ERISA] plans") (citation omitted); *Ingersoll-Rand Co.* v. *McClendon,* 498 U.S. 133, 135-136, 140 (1990) (common law claim for wrongful discharge to prevent attainment of ERISA benefits); *Mackey* v. *Lanier Collection Agency & Serv., Inc.,* 486 U.S. 825, 828 & n.2, 829-830 (1988) (exemption from garnishment statute for ERISA plans). In the case of the state actions outlined above, any restriction on private economic activity arises, not from state regulatory actions, but from the application of ERISA requirements to the plans, service providers, and investment products, that the state, as any other private sector participant in the market, selects in deciding what it is willing to offer.

Finally, it is worth noting that even if the state laws implementing these approaches "relate to" ERISA plans in some sense of that term, it is only because they create or authorize arrangements that are fully governed by ERISA's requirements. By embracing ERISA in this way, the state would not on that basis be running afoul of section 514(a) because ERISA fully applies to the arrangement and there is nothing in the state law for ERISA to "supersede." In this regard, section 514(a) of ERISA, in relevant part, provides that Title I of ERISA "shall supersede any and all state laws insofar as they may now or hereafter relate to any employee benefit plan . . . ." To the extent that the state makes plan design

decisions in fashioning its prototype plan or state sponsored plan, or otherwise adopts rules necessary to run the plan, those actions would be the same as any other prototype plan provider or employer sponsor of any ERISA-covered plan, and the arrangement would be fully and equally subject to ERISA.

This conclusion is supported by the Department's position regarding state governmental participation in ERISA plans in another context. Pursuant to section 4(b)(1) of ERISA, the provisions of Title I of ERISA do not apply to a plan that a state government establishes for its own employees, which ERISA section 3(32) defines as a “governmental plan.” The Department has long held the view, however, that if a plan covering governmental employees fails to qualify as a governmental plan, it would still be subject to Title I of ERISA.[18] In these circumstances, the failure to qualify as a governmental plan does not prohibit a governmental employer from providing benefits through, and making contributions to, an ERISA-covered employee benefit plan.[19] Thus, the effect of ERISA is not to prohibit the state from offering benefits, but rather to make those benefits subject to ERISA. Here too, ERISA does not supersede state law to the extent it merely creates an arrangement that is fully governed by ERISA.

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## Footnotes

1. *For information on the problem of inadequate retirement savings, see the May 2015 Report of the United States Government Accountability Office (GAO), RETIREMENT SECURITY—Most Households Approaching Retirement Have Low Savings (GAO Report-15-419) (available at www.gao.gov/assets/680/670153.pdf (http://www.gao.gov/assets/680/670153.pdf)). Also see GAO's September 2015 Report-15-566, RETIREMENT SECURITY—Federal Action Could Help State Efforts to Expand Private Sector Coverage (available at www.gao.gov/assets/680/672419.pdf (http://www.gao.gov/assets/680/672419.pdf)).*
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2. *Some states are developing programs to encourage employees to establish tax-favored IRAs funded by payroll deductions rather than encouraging employers to adopt ERISA plans. Oregon, Illinois, and California, for example, have adopted laws along these lines. Oregon 2015 Session Laws, Ch. 557 (H.B. 2960) (June 2015); Illinois Secure Choice Savings Program Act, 2014 Ill. Legis. Serv. P.A. 98-1150 (S.B. 2758) (West); California Secure Choice Retirement Savings Act, 2012 Cal. Legis. Serv. Ch. 734 (S.B. 1234) (West). These IRA-based initiatives generally require specified employers to deduct amounts from their employees' paychecks, unless the employee affirmatively elects not to participate, in order that those amounts may be remitted to state-administered IRAs for the employees. The Department is addressing these state “payroll deduction IRA” initiatives separately through a proposed regulation that describes safe-harbor conditions for employers to avoid creation of ERISA-covered plans when they comply with state laws that require payroll deduction IRA programs. This Interpretive Bulletin does not address those laws.*
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3. *For more information, see Choosing a Retirement Solution for Your Small Business, a joint project of the U.S. Department of Labor's Employee Benefits Security Administration (EBSA) and the Internal Revenue Service. Available at www.irs.gov/pub/irs-pdf/p3998.pdf (http://www.irs.gov/pub/irs-pdf/p3998.pdf).*
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4. *2015 Wash. Sess. Laws chap. 296 (SB 5826) (available at http://app.leg.wa.gov/billinfo/summary.aspx?bill=5826&year=2015 (http://app.leg.wa.gov/billinfo/summary.aspx?bill=5826&year=2015)).*
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*5. The retirement plan will be overseen by the Massachusetts State Treasurer's Office. Mass. Gen. Laws ch.29, § 64E (2012). In June 2014, the Massachusetts Treasurer's Office announced that the IRS had issued a favorable ruling on the proposal, but noted that additional approval from the IRS is still needed (see www.massnonprofitnet.org/blog/nonprofitretirement/ (http://www.massnonprofitnet.org/blog/nonprofitretirement/)). See also GAO's Report 2015 Report-15-566, RETIREMENT SECURITY—Federal Action Could Help State Efforts to Expand Private Sector Coverage, which included the following statement at footnote 93 regarding the Massachusetts program: "The Massachusetts official told us that each participating employer would be considered to have created its own plan, characterizing the state's effort as development of a volume submitter 401(k) plan, which is a type of employee benefit plan that is typically pre-approved by the Internal Revenue Service." (GAO report is available at www.gao.gov/assets/680/672419.pdf (http://www.gao.gov/assets/680/672419.pdf)).*
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*6. See IRS Online Publication, Types of Pre-Approved Retirement Plans at www.irs.gov/Retirement-Plans/Types-of-Pre-Approved-Retirement-Plans (http://www.irs.gov/Retirement-Plans/Types-of-Pre-Approved-Retirement-Plans).*
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*7. Governor's Task Force to Ensure Retirement Security for All Marylanders, 1,000,000 of Our Neighbors at Risk: Improving Retirement Security for Marylanders (February 2015) (available at www.dllr.state.md.us/retsecurity/ (http://www.dllr.state.md.us/retsecurity/)).*
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*8. A state developing a state sponsored MEP could submit an advisory opinion request to the Department under ERISA Procedure 76-1 to confirm that the MEP at least in form has assigned those fiduciary functions to persons other than the participating employers. ERISA Procedure 76-1 is available at www.dol.gov/ebsa/regs/aos/ao_requests.html (http://www.dol.gov/ebsa/regs/aos/ao_requests.html).*
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*9. State laws authorizing defined benefit plans for private sector employers (as prototypes or as multiple employer plans) might create plans covered by Title IV of ERISA and subject to the jurisdiction of the Pension Benefit Guaranty Corporation (PBGC). Subject to some exceptions, the PBGC protects the retirement incomes of workers in private-sector defined benefit pension plans. A defined benefit plan provides a specified monthly benefit at retirement, often based on a combination of salary and years of service. PBGC was created by ERISA to encourage the continuation and maintenance of private-sector defined benefit pension plans, provide timely and uninterrupted payment of pension benefits, and keep pension insurance premiums at a minimum. More information is available on the PBGC's Web site at www.pbgc.gov (http://www.pbgc.gov).*
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*10. Different rules may apply under the Internal Revenue Code for purposes of determining the plan sponsor of a tax-qualified retirement plan.*
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*11. See, e.g., Advisory Opinion 2012-04A. See also MDPhysicians & Associates, Inc. v. State Bd. Ins., 957 F.2d 178,185 (5th Cir.), cert. denied, 506 U.S. 861 (1992) ("the entity that maintains the plan and the individuals that benefit from the plan [must be] tied by a common economic or representation interest, unrelated to the provision of benefits." (quoting Wisconsin Educ. Assoc. Ins. Trust v. Iowa State Bd., 804 F.2d 1059, 1063 (8th Cir. 1986)).*
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*12. The Department has also recognized other circumstances when a person sponsoring a plan is acting as an "employer" indirectly rather than as an entity that underwrites benefits or provides administrative services. See Advisory Opinion 89-06A (Department would consider a member of a controlled group which establishes a benefit plan for its employees and/or the employees of other members of the controlled group*

*to be an employer within the meaning of section 3(5) of ERISA); Advisory Opinion 95-29A (employee leasing company may act either directly or indirectly in the interest of an employer in establishing and maintaining employee benefit plan).*
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*13. See Advisory Opinion 2012-04A (holding that a group of employers can collectively act as the "employer" in sponsoring a multiple employer plan only if the employers group was formed for purposes other than the provision of benefits, the employers have a basic level of commonality (such as the participating employers all being in the same industry), and the employers participating in the plan in fact act as the "employer" by controlling the plan).*
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*14. Travelers, 514 U.S. at 658 (1995); Ingersoll-Rand Co. v. McClendon, 498 U.S. 133, 142 (1990); Egelhoff v. Egelhoff, 532 U.S. 141, 148 (2001); Fort Halifax Packing Co. v. Coyne, 482 U.S. 1, 14 (1987).*
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*15. In the Department's view, a state law that required employers to participate in a state prototype plan or state sponsored multiple employer plan unless they affirmatively opted out would effectively compel the employer to decide whether to sponsor an ERISA plan in a way that would be preempted by ERISA.*
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*16. The Court in Travelers approved a New York statute that gave employers a strong incentive to provide health care benefits through Blue Cross and Blue Shield as opposed to other providers. The Court noted that the law did not "mandate" employee benefit plans or their administration, or produce such acute economic effects, either directly or indirectly, by intent or otherwise "as to force an ERISA plan to adopt a certain scheme of substantive coverage or effectively restrict its choice of insurers." Travelers, 514 U.S. at 668. See also De Buono v. NYSA-ILA Medical and Clinical Services Fund, 520 U.S. 806, 816 (1997).*
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*17. State laws relating to sovereign immunity for state governments and their employees would have to be evaluated carefully to ensure they do not conflict with ERISA's remedial provisions.*
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*18. See, e.g., Advisory Opinion 2004-04A.*
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*19. See Information Letter to Michael T. Scaraggi and James M. Steinberg from John J. Canary (April 12, 2004).*
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GEORGETOWN UNIVERSITY
McCourt School of Public Policy
Center for Retirement Initiatives

# Review of Potential Public Retirement Plan Options for Private Sector Employees/Employers in the State of Vermont

Submitted to:

Office of the Vermont State Treasurer
Public Retirement Study Committee

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MEP sponsored by a state or local government may allow any business employing state residents to join the program. These so-called "open" MEPs would allow, for example, a state to create a unified program available to all employers. This discussion assumes that any state-sponsored MEP would be open.

A separate trust would hold contributions made by participating employers, employer's employees, or both. The state, or designee, would be the plan sponsor and named fiduciary and plan administrator for administering the plan and could contract out to private sector providers to do so. Under a state MEP, each employer that participates would not be considered to have established its own ERISA plan, rather DOL would consider this arrangement a single ERISA plan.[132] Therefore, the state would have economies of scale in lowering administrative and other costs.

The state MEP would be distinguishable from other business enterprises that underwrite benefits or provide administrative services to several unrelated employers because the DOL views a state as having a unique representational interest in the well-being of its citizens that connects it to the in-state employers that choose to participate in the plan. Therefore, the state would be acting indirectly in the interest of the participating employers, which is in line with the requirement under Title I of ERISA relating to a person, other than an employee organization, who wishes to sponsor an employee benefit plan.

Although participation in a state open-MEP must be voluntary, its plan design features can include the use of auto-enrollment and auto-escalation, features that are not available to payroll deduction IRAs unless the state mandates employer participation.

While DOL's guidance allows for state open-MEPs, it did not extend the guidance to "open" MEPs for privately established plans and this has been subject of several congressional proposals in recent years.[133]

**Establishing a State MEP**. A MEP must have a plan sponsor, which could be the state itself, but more likely a board, committee or other entity appointed or created by the state through enabling legislation. For convenience, this discussion will use the term "board" to refer to all government-appointed administrators. The board would set the program's terms, prepare plan documents and select investments, hire trustees, custodians, recordkeepers and other service providers. Employers would voluntarily join the MEP by signing an adoption agreement.

DOL rules allow cities, counties and other state political subdivisions to sponsor MEPs. For convenience, this discussion refers to "states," although the same federal rules apply to state political subdivisions.

**Why MEPs?** A MEP offers several advantages for employers, especially smaller to mid-sized employers, and their employees. First, by commingling assets a MEP may achieve the economic heft to obtain lower investment and administrative fees, more sophisticated investment opportunities, top-shelf service providers and add-ons like financial education and advice. Second, a MEP offers employers a simplified, turnkey process for obtaining a plan document, selecting and monitoring the investment platform and the recordkeeper, IRS reporting, obtaining an independent audit, and similar chores.

Finally, by outsourcing most of the heavy lifting to the sponsor and its team of outside experts, employers can significantly minimize their exposure to possible ERISA liability. Today, small businesses

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[132] 80 Fed. Reg. 71,938 (November 18, 2015)

[133] For example, the Retirement Enhancement and Savings Act of 2016 (S. 3471) was introduced by Senator Orrin G. Hatch (R-UT) on November 16, 2016. This bill includes retirement savings reform which would make multiple employer plans more attractive by eliminating barriers and improving the quality of MEP service providers. For more information about other private sector MEP related proposals, please see http://cri.georgetown.edu/federal-legislative-proposals/.

tend to avoid offering retirement benefits because they are too expensive and too time-consuming to manage, and they expose the company to liability if something goes wrong. On the other hand, the economies of scale generated by numerous businesses joining in a single plan should make a state-sponsored program less expensive and the board with its selected cadre of investment managers, advisors and service providers make the plan more attractive to employers.

Participating employers in a state-sponsored program that is a MEP also should have minimal ERISA fiduciary responsibility (basically whether to join, remain in, or leave the plan) and thus, minimal liability exposure. In a non-MEP collection of single plans, each employer may be viewed as having greater fiduciary responsibility for plan functions and thus, greater potential liability. Also, as discussed in Section III, MEPs enjoy exemption from the federal securities laws that could otherwise treat the program as a "security" or "regulated investment company."

There are several regulatory and cost advantages to being treated as a MEP. As a MEP, one IRS Form 5500 Annual Report is filed, one ERISA fidelity bond purchased, and a single annual audit by an independent accountant conducted for the entire plan.

*State Action*

To date, no state has proposed a program that is solely a state-sponsored MEP. However, the New York City Comptroller's Office and Massachusetts have explored combining a MEP option with other options. These combination or multi-tiered approaches are discussed more in the subsection "State Sponsored Combination or Multi-Tiered Models."

***Master and Prototype Plans***

To establish a prototype plan, a provider would develop standard form 401(k) or other tax-favored retirement plans (i.e., SIMPLE-IRA plans) and obtain IRS approval. Each employer, in adopting the prototype, would sponsor an ERISA plan for its employees. Banks, insurance companies and other regulated financial institutions commonly market prototype plans to employers as simple means for them to establish and administer employee benefit plans. Each employer that adopts the prototype sponsors an ERISA plan for its employees and they can choose features such as contribution rates that meet their needs. The individual employers would assume the same fiduciary obligations associated with sponsorship of any ERISA-covered plans. For example, the prototype plan documents often specify that the employer is the plan's "named fiduciary" and "plan administrator" responsible for complying with ERISA, but they may allow the employer to delegate most of these responsibilities to others.[134]

*Federal Legal and Regulatory Issues: DOL Guidance for Prototype Plans*

Based on DOL Interpretive Bulletin, under a state-administered prototype plan, the state could allow employers to delegate many of its ERISA fiduciary and administrative responsibilities to the state or state designee, which would leave the state or a third party selected by the state to assume responsibility for most administrative and asset management functions of the plan.

As is the case with state open-MEPs, employer participation in a prototype plan must be voluntary, but can use features such as auto-enrollment with an opt-out and auto-escalation, features that are not available to payroll deduction IRAs, unless the state mandates employer participation.

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[134] See IRS Online Publication, "Types of Pre-Approved Retirement Plans." www.irs.gov/Retirement-Plans/Types-of-Pre-Approved-Retirement-Plans.

Federal Legislative Efforts Related to MEPs. There has been general bipartisan support in Congress to make MEPs more user-friendly.[189] Numerous bills would eliminate the bad apple rule for any employer error, either by directing the IRS to revise its rules or by revising the text of the Code. Note even with the change, a Tax Code violation by the state sponsor could infect the entire program. There also are several proposals to allow private sector vendors the same flexibility as states to sponsor open MEPs the commonality rule discussed above. Finally, some are urging Congress to direct the DOL and IRS to allow single Form 5500 to be filed by non-MEPs. States interested in sponsoring a MEP could encourage Congress to legislatively remove the bad apple rule and the commonality requirement and generally direct the IRS, DOL and the Securities and Exchange Commission (SEC) to take a pro-MEP approach.

## Other Legal and Regulatory Considerations for Plan Design Options: Federal Securities Laws and the Patriot Act

This section answers some questions about how federal securities laws might apply to DC plan design options and identifies another federal law—the Patriot Act—that also must be considered.

### *Federal Securities Laws*[190]

A primary aim of securities laws is to protect investors—particularly small "retail" investors—by requiring, among other things, full and fair disclosure of information on investments, fees, advisors and the like. While several federal securities laws could be relevant to auto-IRAs, two key statutes are the Investment Company Act of 1940 (40 Act) and the Securities Act of 1933 (33 Act). The 40 Act regulates mutual funds and other "investment companies." The 33 Act regulates the offer and sale of "securities," defined broadly as ordinary stocks and bonds and mutual fund shares and certain "investment contracts."

Federal securities laws raise two basic questions: are state-sponsored mandatory auto-IRA programs *themselves* exempt; and can a state retirement savings program offer the type of investments available to 401(k) and other savings plans but not regular IRAs? The answers to both questions should be yes.

*Are State or Other Government Plans Exempt?*

Federal securities laws generally exempt states and their agencies or instrumentalities (state instrumentalities) from regulation as investment companies under the 40 Act and any securities issued by a state instrumentality are similarly exempt from registration under the 33 Act. If state-sponsored retirement plans for private sector workers are viewed as state instrumentalities, it follows logically that an auto-IRA program should be exempt from federal securities law regulation. This makes perfect sense both legally (the programs are created by state law, intended to benefit state citizens and operated under state supervision) and as a policy matter because program participants will be well-protected by state boards and trustees, who will in turn be advised by a team of experts. In fact, auto-IRA participants would not be your typical IRA owners in the market place because the state boards and their advisors will be vetting and monitoring service providers and products.

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[189] The President's Fiscal Year 2017 Budget provides open creation for open MEP plans. https://www.whitehouse.gov/sites/default/files/omb/budget/fy2017/assets/opportunity.pdf.

[190] This discussion draws heavily from Morse, David (2016), "Beyond ERISA: Other Regulatory Considerations for State-Sponsored Retirement Plans (Blog Post)," Georgetown Center for Retirement Initiatives. http://cri.georgetown.edu/beyond-erisa-other-regulatory-considerations-for-state-sponsored-retirement-plans/.

a state-sponsored MEP where the plan, but not the employer, had over 100 participants.) One way to judge how fast an employer could reasonably segregate its 401(k) contributions is to look at how quickly an employer can forward tax withholdings to the IRS. The contribution timing rule also applies to loan repayments made through payroll.

Smaller employers, perhaps using an outside service but still relying on a multi-tasking employee to manage payroll, can find this rule challenging. Recognizing the difficulty, the DOL has created a correction program that allows offending employers to add an interest factor (calculated on the DOL website) to each employee's late contribution. An employer's occasional violation can be self-corrected, while more frequent problems should be reported using the DOL voluntary correction program. Of course, chronic lateness or fraud are serious violations that could lead to penalties and other sanctions.

Late contributions should be viewed as an employer issue that the state sponsor is neither able to police nor remediate. The MEP plan documents should make this clear. As open 401(k) MEPs coverage grows, states, employers, the DOL and IRS will likely develop additional solutions.

ERISA Fiduciary Concerns. The state board can, and should, hire investment advisors and recordkeepers to accept responsibility for the heavy lifting of investing and operating the plan and agree to indemnify the board if something goes amiss. Of course, the board still would retain its ERISA duty to locate, hire, monitor and replace (if necessary) those vendors. The board should retain expert consultants and attorneys to help with these duties. Recall that ERISA does not impose a duty of perfection and, by using having and following proper procedures and governance, a board would generally be absolved from liability if one of those vendors turned out to be a loser. Indeed, most states already have in place detailed request for proposal and contracting rules to manage the process. *

A board could purchase fiduciary insurance to further mitigate its exposure. That insurance should be purchased with outside (and not plan) funds. Otherwise, any insurance recovery would belong to the plan. Everything considered, the combination of outsourcing, indemnification, sound governance, outside experts and fiduciary insurance should allow even the most nervous board member to sleep at night.

One exposure for ERISA liability that cannot be simply outsourced or insured away is for the board's own fraud, malfeasance or complete abdication of duties. But there should be plenty of checks, balances, outside auditors and procedures to prevent this type of abuse.

From the employers' side, joining and remaining in a MEP are considered fiduciary decisions. The potential ERISA liability from an employer's participating in a state-sponsored MEP, backed by a team of experts and seasoned providers, would seem almost illusory.

This is mitigated. Also! Sen Hatch looking at Legislation w/ Fix but either way not a show stopper

Mistakes, Corrections & Bad Apples. Violation of any of the Tax Code requirements could, in theory, cause any plan, including a MEP, to be "disqualified." Disqualification is the IRS's nuclear option, causing the plan to retroactively lose all favorable tax benefits, immediately taxing participants on their vested benefits, even if not paid out, and the plan to pay income tax on its investment earnings; and the employer to lose some of its tax deduction on contributions; plus interest and tax penalties imposed on everyone.

Under the controversial "bad apple" rule, the IRS treats one employer's violation—say of the top-heavy or 415 benefit limitations—as infecting the entire plan.[186] Because of the draconian consequences, the IRS is loath to disqualify a plan. Instead, it has created a series of procedures where an employer can

[186] Treas. Reg. 1.413-2(a)(3)(iv).

correct a qualification defect.[187] Depending on the relative size and nature of the error, and how it was caught (by the employer and self-corrected and/or reported or by the IRS on audit), almost all errors may be fixed by undoing the mistake, making all participants whole and perhaps, by the employer paying an IRS user fee or penalty.

In a MEP the plan administrator (not the employer which messed up) must orchestrate the correction and apply for IRS relief.[188] The administrator may allocate any IRS compliance fee or penalty to the offending employer[s], rather all employers. A well-designed MEP would include procedures for identifying and correcting mistakes and allocating the costs of correction and authorizing the administrator to compel the employer[s] to fully cooperate and assume financial responsibility for its non-compliance.

Even with the correction procedures and the important policy goals of a state-sponsored MEP, some states and employers may not feel entirely comfortable relying on the common sense and good graces of the IRS in correcting errors. While careful plan design can reduce the likelihood of a qualification error and make the offending employer pay for its own mistakes, the bad apple rule may be the most troubling aspect of joining a MEP. It also does not serve any regulatory purpose to punish the innocent along with the guilty. Either the IRS will decide to revise its policy or Congress should pass legislation repealing the bad apple rule. Until then, the bad apple rule could be a factor in a state's decision to take a prototype plan approach; avoiding one problem at the possible cost of forgoing the many advantages of a MEP.

Sen Hatch doing this

We disclosed this issue in testimony, thought was to go ahead anyways by Senate Economic Develop Committee

## State or Employer Termination of MEP Participation

Can a state exit its MEP? A state may determine that it no longer wishes to sponsor a MEP, for example because the retirement plan market has expanded to offer many strong private sector alternatives. In that case, a state would have two alternatives. First, it could find a qualified private sector provider to take over and transfer sponsorship. Of course, this is a fiduciary action and the state would want to obtain airtight indemnification from the new sponsor. Second, the state could terminate the MEP. This process would involve giving employers the opportunity to set up their own replacement plans and, for the remainder of the MEP, fully vesting all participants, applying to the IRS for a determination letter that the termination comports with the tax qualification rules and distributing benefits to all participants. While a termination would be a cumbersome process, states should be comforted in knowing they have an "out."

Can employers withdraw from a MEP? A MEP can (and should) allow an employer to withdraw by "spinning off" the employer's slice of assets and benefit obligations into its newly established plan and trust. Participants' vested and non-vested benefits must be preserved in the new plan. The MEP's administrator would likely have an ERISA fiduciary duty to obtain assurances from the employer that the new plan appropriately treats participant benefits.

It also would be possible for an employer with an existing plan to transfer that plan into a MEP. However, under the existing ERISA and tax rules any defect in employer's plan could port over to the MEP, potentially infecting the entire program. It is doubtful that an administrator would want to put in the time and expense of due diligence of the employer plan and, absent a change in law, it would be inadvisable for most MEPs to accept a transfer from existing plan.

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[187] Rev. Proc. 2016-51.

[188] Rev. Proc. 2016-51; section 11.03.11.

Federal Legislative Efforts Related to MEPs. There has been general bipartisan support in Congress to make MEPs more user-friendly.[189] Numerous bills would eliminate the bad apple rule for any employer error, either by directing the IRS to revise its rules or by revising the text of the Code. Note even with the change, a Tax Code violation by the state sponsor could infect the entire program. There also are several proposals to allow private sector vendors the same flexibility as states to sponsor open MEPs the commonality rule discussed above. Finally, some are urging Congress to direct the DOL and IRS to allow single Form 5500 to be filed by non-MEPs. States interested in sponsoring a MEP could encourage Congress to legislatively remove the bad apple rule and the commonality requirement and generally direct the IRS, DOL and the Securities and Exchange Commission (SEC) to take a pro-MEP approach.

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