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By E-mail and FedEx

Katie Selenski
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Re: California Secure Choice

Dear Ms. Selenski:

The California Secure Choice Retirement Savings Trust Act (the "**Act**") established the Secure Choice Retirement Savings Board ("**Board**") and instructed the Board to design and establish a retirement savings program for private sector workers ("**Secure Choice**" or the "**Program**").[1] The Act provides that the Board may not implement Secure Choice if it would be considered an employee benefit plan under the Employee Retirement Income Security Act ("**ERISA**").[2] In addition, the Act expressly required that the Program qualify as a non-ERISA plan under an anticipated Department of Labor ("**DOL**") "safe harbor" regulation covering state-based IRA savings programs. Such a regulation was issued as DOL Regulation Section 2510.3-2(h) ("**2016 Safe Harbor**"). However, the 2016 Safe Harbor is expected to be revoked under the Congressional Review Act ("**CRA**").[3] While I understand that the California legislature intends to eliminate the reference to the 2016 Safe Harbor from the Act, the requirement that Secure Choice may not be an ERISA-regulated plan is expected to remain.

You have asked my advice on the effect of the CRA disapproval resolution on Secure Choice, in particular the Board's efforts to develop the Program as a non-ERISA savings vehicle. Subject to the discussion and assumptions below, I believe that pre-2016 DOL safe harbor guidance and applicable case law provide firm grounds for the Board to accomplish its mission to design and implement Secure Choice as a non-ERISA savings program for private sector workers in California. In addition, I believe that current law should not impede the Board if it chooses to consider Program designs using an "opt out" negative election approach.

My analysis assumes that the description of the Program below is accurate; the Act will be amended to remove references to the 2016 Safe Harbor; and the Board intends to design, implement and administer the Program in accordance with the conditions in the remaining safe harbor guidance. Please note that the final authority to determine whether the Program as it is ultimately designed is not an ERISA employee benefit plan rests with the courts and it is possible that a court could take a different view than expressed in the 1975 Safe Harbor (as defined below) or in my analysis. Further, my advice is based on an analysis of relevant provisions of applicable laws, regulations and regulatory interpretations currently in effect. Because such laws, regulations and interpretations are subject to change, either prospectively or retroactively, the Board should continue to monitor developments in this area to determine whether future judicial or regulatory developments may affect the analysis or conclusions in this letter.

What follows is a brief description of the Program; a summary of the 1975 Safe Harbor; the application of such safe harbor to the Program as currently envisioned; and the impact of the CRA resolution recently passed by Congress, which the President is expected to sign, disapproving the 2016 Safe Harbor and a brief summary of applicable case law.

Expected Secure Choice Design

Under the Act, Secure Choice will be a state-based payroll withholding savings program using individual retirement accounts ("**IRAs**") under Sections 408 and 408A of the Internal Revenue Code of 1986, as amended. Under the Act, certain employers will be required to provide access to the Program to their Californian employees, who are not covered by a 401(k) or other workplace retirement plan. All IRA assets will be held in a trust fund established under California law (the "**Trust Fund**"). Trust Fund assets will be invested in investments selected by the Board or by third-party investment advisers or managers retained by the Board pursuant to Board-established policies and guidelines.

The Board has broad discretion to "design and implement" the Program and adopt regulations governing the Program.[4] The Board intends to retain retirement and investment consultants, recordkeepers/administrators, legal counsel and other experts to assist in the design, implementation and operation of its Program.

Employer involvement in Secure Choice will be limited and employers will be prohibited from receiving any compensation in connection with the Program. Employers will be required only to provide census information for their California employees, distribute the disclosure documents and withhold and remit employee contributions to the Trust Fund.[5] Employers will not be liable for an employee's decision to participate in, or opt out of, the Program or for employee's investment decisions.[6] While the Act provides the Board with discretion to permit employer contributions if such contributions would not result in the Program being considered an

employee benefit plan under ERISA, the Board does not intend to permit employer contributions.

The Board currently intends to select a "default" contribution rate and investment vehicle for eligible employees. Under this approach, no amounts will be withheld from an eligible employee or contributed to the Program unless the employee submits to the Board or its designee an acknowledgment that he or she has read and understood the Program disclosures. Such disclosures will include a plain English description of the default contribution rate and investment vehicle and instructions on how to select a different contribution rate and, if employees are offered a choice of investments, other investment vehicles. Program disclosures also will explain to employees that: (i) the Program is not sponsored by their employer and the employer is not responsible for the Program or liable as a plan sponsor; (ii) their employer will not provide financial advice and they should contact their own financial advisors for advice; and (iii) their employer is not liable for any decisions that the employees make regarding whether to participate in the Program or how to invest their IRAs under the Program.[7] As currently envisioned, an employee who does not submit the disclosure form will not be permitted to contribute to the Program.

ERISA

ERISA Coverage. ERISA covers employee benefit plans "established or maintained by an employer."[8] The typical IRA is not regulated by ERISA because it is set up and funded by an individual, not his or her employer. However, an IRA program that is offered through the workplace to employees could be considered an ERISA plan if, for example, there is significant employer involvement.

The DOL has issued two sets of ERISA "safe harbors" covering payroll deduction IRA programs. First, a 1975 DOL regulation established a general safe harbor ERISA for payroll withholding IRAs satisfying certain conditions including most notably that employers refrain from endorsing the program so employee participation is completely voluntary.[9] (This regulation, together with subsequent DOL interpretative guidance and advisory opinions, will be referred to as the "**1975 Safe Harbor**"). The 1975 Safe Harbor predated the efforts by California and other states to establish a state-run mandated payroll withholding IRA savings program for private sector workers. The second DOL regulation was the 2016 Safe Harbor, which provided additional safe harbor protection specifically for state automatic enrollment IRA programs. However, the 2016 Safe Harbor would be repealed upon the President's signature (or non-action) on the CRA disapproval resolution.[10]

1975 Safe Harbor. DOL Regulation Section 2510.3-2(d) provides that a payroll deduction IRA program will not be considered a pension plan subject to ERISA if: (i) no contributions are made by the employer; (ii) the sole employer involvement is collecting contributions through payroll

deductions, remitting them to the IRA sponsor and publicizing the program to employees without employer-endorsement; (iii) the employer receives no compensation (other than for certain permitted services actually performed); and (iv) employee participation is completely voluntary.

The DOL expanded the scope of this four-part regulatory safe harbor by issuing Interpretive Bulletin 99-1 (the "**Bulletin**") as part of its efforts "to encourage retirement savings through payroll deduction IRAs." The Bulletin noted that "over half of the private wage and salary workforce does not have employment-based retirement coverage" and that this lack of coverage was most prevalent among employers with fewer than 100 employees. The Bulletin then observed that small employers do not sponsor retirement plans in part due to the "administrative complexity and burden" and the "risk of commitment to an ongoing expense in the face of financial uncertainties." Although the DOL recognized that employees could always set up their own IRAs, it concluded that employees are more likely to "make use of an individual retirement savings vehicle that is offered in an employment setting and features regular withholding." The Bulletin stressed the DOL's "long-held view that an employer who simply provides employees with the opportunity for making contributions to an IRA through payroll deductions does not thereby establish a pension plan."

The Bulletin discussed that the non-employer endorsement and voluntary participation requirements are interrelated. Thus, the Bulletin stated that to be "completely voluntary" the employer cannot endorse or recommend either the IRA sponsor or the funding media" and should inform employees that other IRA vehicles are available outside the program and that an IRA may not be appropriate for all employees. On the other hand, an employee's participation would not be voluntary if he or she was coerced into contributing.[11]

Some employer involvement is allowed in a payroll deduction IRA without jeopardizing the ERISA exemption. Thus, in a payroll IRA program that was invested in a group annuity contract, the DOL permitted the employer, as contract holder, to vote on the annuity provider's upcoming plan of demutualization and elect the method for allocating the demutualization proceeds among IRA participants.[12] The DOL based its ruling on three factors: (i) the actions of an independent third party caused the need for the employer to act; (ii) the employer would be acting in accordance with New Jersey insurance law; and (iii) the employer's actions were one-time acts that would not involve the employer retaining any on-going discretion in administering or operating the IRAs.

An even greater and ongoing level of employer involvement was allowed by the DOL when it ruled that an employer could select three IRA sponsors from a pool of applicants, periodically review each sponsor's performance, replace any underperformers and negotiate for and receive a written indemnification from each sponsor.[13] The DOL found that these activities "would not result in endorsement or involvement beyond that permitted under the regulation" and would not

prevent the program from qualifying under the 1975 Safe Harbor.

Scope of CRA. The CRA provides Congress with a simplified procedure to issue a "disapproval resolution" revoking certain recent federal regulations and prohibiting federal agencies from issuing a new rule that is "substantially the same" as the revoked regulation.[14] The disapproval resolution states that the 2016 Safe Harbor will have "no force or effect" and also appears to revoke the related "preambles" published by the DOL with the regulation.[15] (The CRA resolution cites to the first page of the Federal Register entry as opposed to the page where the actual Safe Harbor regulation begins and the CRA defines the disapproved rule as including "an agency statement of general or particular applicability."[16]) The disapproval resolution revoking the 2016 Safe Harbor does not reference the 1975 Safe Harbor.

1975 Safe Harbor and Secure Choice. Based on our understanding of the expected terms and conditions, the Secure Choice Program should be able to qualify for the 1975 Safe Harbor exemption from ERISA regulation. Employer contributions will not be allowed; employer involvement will be limited to certain ministerial acts such as distributing information and collecting and remitting payroll withholding; employers will receive no compensation or other amounts for participating in the Program; and employee contributions will be made pursuant to employee elections. Program disclosures to employees will highlight the employer's limited involvement and that the Program is not intended to be an ERISA-governed retirement plan and employees should consider alternative IRA and other savings arrangements and consult with their own advisors for tax and investment advice.

Automatic Enrollment; Alternatives to 1975 Safe Harbor. While the Board has not yet developed the contribution election process, there are strong arguments that a program using automatic enrollment with *opt out* elections also could satisfy the 1975 Safe Harbor. In deliberating whether and under what terms to issue the 2016 Safe Harbor, the DOL argued that a payroll withholding program that nudged employees into savings through automatic enrollment elections would not satisfy the "completely voluntary" condition of the 1975 Safe Harbor. (For purposes of this discussion, the term "automatic enrollment" includes both automatic enrollment and automatic escalation of contribution rates with an employee opt out.) While this position was enunciated in the presumably revoked preambles to the proposed and final 2016 Safe Harbor, it would remain relevant to the extent it reflects the DOL's reading of the 1975 Safe Harbor and the nature of negative elections with an opt out.[17]

The preambles to the proposed and final 2016 Safe Harbor explained the DOL's view that a program's auto-enrollment/escalation feature could cause an employer to exercise undue influence over an employee's participation and that contributions made without an affirmative election might not be completely voluntary. The DOL emphasized the relationship between the employer endorsement and the completely voluntary conditions in the preamble to the proposed

2016 Safe Harbor. For example, according to the DOL, the "completely voluntary" requirement means that the decision to enroll in an IRA program established under the 1975 Safe Harbor must be "self-initiated" (i.e., not coerced by the employer) "**where the employer is acting on his or her own volition** to provide the benefit program, the employer's actions—e.g., requiring an automatic enrollment arrangement—would constitute its 'establishment' of a plan within the meaning of ERISA ... ." [18] Under the DOL's statements such differing requirements (assuming there is a difference between a voluntary and completely voluntary election) would be unnecessary if the employer's offering of the program is required by state law and the employer has no say in its terms or conditions; in such case the element of "employer volition" would be absent, with the result that any employee participation in the program should be viewed as "[completely] voluntary."

Finally, a regulatory safe harbor is just that: it provides a bright-line standard for identifying programs that are not covered by ERISA, but does not cover the landscape for what is or is not an ERISA plan. Thus, a state-mandated IRA savings program, using either opt out or opt in contribution elections, should be considered to be a non-ERISA plan if the element of employer volition in the process of establishment or maintenance of the program is absent. [19]

Federal Case Law. ERISA's regulation of employee benefit plans presumes a level of administrative and operational activity, as it is the employer's activities with respect to a plan that are vulnerable to abuse.[20] The purpose of the "established or maintained" requirement is to "ascertain whether the plan is part of an employment relationship by looking at the degree of participation by the employer in the establishment or maintenance of the plan."[21] A plan is established when the employer has taken affirmative steps to extend benefits by, for example, financing or arranging financing to fund benefits, establishing a procedure for disbursing benefits or representing to employees that a plan exists.[22] Without documentary evidence, even an employer's alleged promise to provide benefits does not establish an ERISA plan.[23]

The Supreme Court has found that a plan does not exist when an employer assumes no responsibility to pay benefits on a regular basis such that there is no need for ongoing administrative practices associated with the provision of benefits.[24] The question of whether a plan is "established or maintained by an employer" is one of fact "to be answered in light of all the surrounding facts and circumstances from the point of view of a reasonable person."[25] In applying this test, the crucial factor is whether the employer intends to provide benefits on a regular and long-term basis.[26] To ascertain whether an employer has established an ERISA benefits plan courts will look to: (1) internal or distributed documents; (2) oral representations; (3) the existence of a fund or account to pay benefits; (4) actual payment of benefits; (5) a deliberate failure to correct known perceptions of a plan's existence; (6) the reasonable understanding of employees; and (7) the intentions of the putative sponsor.[27] These and similar

judicial precedents support a conclusion that IRAs established pursuant to the Program should not be considered ERISA plans "established or maintained" by covered California employers

As Secure Choice coalesces over the next several months, I would be pleased to discuss these issues further.

Sincerely,

David E. Morse

cc: Robert Hedrick
William P. Wade

[1] California legislation enacted in 2012 established the Secure Choice Retirement Board and authorized the Board to conduct a detailed market analysis and make recommendations for an IRA-based program. Based on the Board's recommendations (see footnote 6), the California legislature in 2016 enacted SB 1234, which officially established the Program. CA Gov't Code ("**CA Law**") §§ 100000-44 (West 2016 Supp.).

[2] Act § 100043(a).

[3] Congress has passed the disapproval resolution, H.J. Res 66, 115th Cong. (2017), and the President is expected to either sign the resolution or allow it to become law through non-action.

[4] Act. §§ 100002(e), 100048.

[5] *Id.* § 100014(c).

[6] CA Law § 100034(a).

[7] Act § 100014(c).

[8] ERISA § 3(3).

[9] DOL Reg. § 2510.3-2(d).

[10] H.J. Res 66, 115th Cong. (2017).

[11] DOL Interpretive Bulletin 99-1.

[12] DOL Advisory Opinion 2001-03A (Feb. 15, 2001).

[13] DOL Advisory Opinion 82-27A (Jun. 16, 1982).

[14] CRA § 801(b)(2).

[15] H.J. Res 66, 115th Cong. (2017).

[16] U.S.C. § 551(4).

[17] We are assuming (without expressing our view) for this portion of our advice that the CRA's proscription against the DOL's issuing new rules similar to the 2016 Safe Harbor would not affect the DOL's ability to issue regulatory guidance concerning whether a payroll withholding IRA program would fall within the 1975 Safe Harbor or otherwise be subject to ERISA.

[18] Proposed Safe Harbor, 80 Fed. Reg. 72006, 72008 (Nov. 18, 2015) (emphasis added).

[19] ERISA §§ 3(2)(A), 3(3), 4(a).

[20] *Fort Halifax Packing Co. v. Coyne*, 482 U.S. 1, 16 (1987).

[21] *Peckham v. GEM State Mut. of Utah*, 964 F.2d 1043, 1049 (10th Cir. 1992) (holding that an employer's subscription to a multi-employer group insurance trust that provides employers with insurance for their employees, the purchase of insurance for its employees and the listing of insurance in the company manual as an employee benefit created an employment relationship in satisfaction of the "established or maintained" requirement).

[22] *Ed Miniat, Inc. v. Globe Life Ins. Group, Inc.*, 805 F.2d 732, 739 (7th Cir. 1986).

[23] *See, e.g., Harris v. Arkansas Book Co.*, 794 F.2d 358, 360 (8th Cir. 1986) (holding that an employer's alleged promise to provide retirement benefits did not constitute the establishment of an employee pension plan despite making payments to another employee following that employee's retirement).

[24] *Halifax Packing Co.*, 482 U.S. at 12.

[25] *Deibler v. United Food & Commercial Workers' Local Union 23*, 973 F.2d 206, 209 (3d Cir. 1992).

[26] *See Deibler*, 973 F.2d at 209 (citing *Wickman v. Nw. Nat'l Ins. Co.*, 908 F.2d 1077, 1083 (1st Cir. 1990)).

[27] *Henglein v. Informal Plan for Plant Shutdown Benefits for Salaried Employees*, 974 F.2d 391, 400 (3d Cir. 1992).