Legislative Update

Legislative Trends: State Automatic IRA Retirement Plan Mandates Gain Momentum

Eye on Washington's new series focuses on the latest HR regulatory trends taking place at the federal, state, and local level. Topics include tax and HR compliance, Health Care Reform, payroll, benefits, leaves, reporting obligations, and more.

On May 27, 2016, Connecticut enacted Act No. 16-29 (HB5591), An Act Creating The Connecticut Retirement Security Program, becoming the fifth state in recent years to require certain employers that do not already sponsor a retirement savings plan to automatically enroll workers in a state-run retirement savings plan. Other states with a similar mandate include California, Illinois, Maryland, and Oregon. These state laws are expected to be implemented in 2017 (e.g., Illinois, Oregon) and 2018 (e.g., California, Connecticut).

As background, in November 2015, the U.S. Department of Labor (DOL) published **guidance** designed to facilitate state plans and permit states to mandate employer participation in a payroll deduction IRA for employees that are not eligible for a qualified retirement plan. The goal of the DOL rule and related state legislation is to expand access to retirement savings plans through the workplace. Studies have established that as much as half of the workforce does not have access to a payroll deduction retirement savings plan. Further, studies have shown that automatic enrollment in such plans increases participation dramatically.

The Connecticut Retirement Security Program

In the Connecticut Act, employers are subject to the mandate if they employed at least five employees on October 1st of the preceding year, and paid each employee at least $5,000 in the prior year. The Act excludes government entities and employers in business for less than two years, as well as employers that maintain a qualified retirement plan.

Employers will be required to furnish information about the program to all existing employees, and to new employees within 30 days of their hire date, or once they qualify for coverage (i.e., attained age 19 and have been employed at least 120 days). Such materials will explain the benefits and risks; how to make contributions to the program and how to opt out, among other things. Employers must also furnish notices about the program to employees annually. Within 60 days of providing the informational materials, the employer must automatically enroll each eligible employee in the program.

Employees may opt out at any time. However, if they do not opt out, employers must begin withholding retirement plan contributions at a default rate of three percent, and must forward amounts withheld to the state-run plan within a specified time frame. Deductions are after-tax and are considered a Roth IRA under Section 408A. Employers are not permitted to make contributions, such as an employer matching contribution, to the program.

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The law is effective in January 2018, but provides that the state may defer the effective date of the program for certain categories of employers. So, the program may be phased in over time.

If a qualified employer fails to enroll a covered employee, either the employee or the Labor Commissioner may bring a civil action to require the qualified employer to enroll the covered employee, and shall recover court costs and attorney's fees.

State "Automatic IRA" Mandates to Date Are Diverse

Other states' laws vary somewhat as to coverage and other matters. Such laws generally exclude government employers, and many exclude new employers and those that employ less than a specified number of workers (e.g., five employees in California and Connecticut, 25 in Illinois). Employers that sponsor a retirement savings plan are generally excluded; however, the laws are unclear as to potential coverage related to employees that are not eligible for the retirement plan (such as part-time, contingent, or temporary workers). Employees under 18 are excluded in some states, while Connecticut excludes those under age 19. Some laws have adopted unemployment insurance definitions of covered employers and employees, while others adopted state income tax laws for such definitions. This could introduce complications for employees who travel or telecommute, because they could be subject to conflicting coverage under more than one state law.

Although the State Automatic IRA plans are designed to minimize employer involvement, certain complications may arise. For example, while deductions are considered a Roth IRA under Section 408A, employees with income exceeding a specified maximum may not qualify for a Roth IRA. In addition, the annual maximum that can be contributed by any individual (including all accounts, and both Roth and traditional IRAs) is $5,500 for those under age 50, and $6,500 for individuals age 50 or older. Given that an employer may not know the full-year income of new hires or amounts that an employee may have already saved in an IRA, this may result in the employee or the state advising the employer to re-characterize deductions as traditional (pretax) IRA deductions. Or, the employee or state may direct the employer to stop withholding for the balance of the year. Employers may need to keep separate records of Roth IRA and traditional IRA deductions for affected employees.

Although automatic enrollment in retirement plans has been adopted by many employers, there may be complications. For example, a state or designated financial agent must perform certain diligence in opening a financial account for employees, and may notify the employee and/or employer of problems in establishing the account (e.g., if a name and/or Social Security Number do not match the government database). States have yet to publish details as to when and how this may occur, but retirement plan deductions may already have been made and remitted by the employer.

Further, the requirement to furnish notices to employees may vary in terms of timing, content, handling and other matters. For example, the California statute requires that each employee sign and date the notice to acknowledge that the employee has read all of the disclosures and understands their content. Employers may be required to keep copies of signed disclosure notices.

Penalties for employer noncompliance also vary considerably. In California and Illinois, employers can be fined $250 per employee for failure to enroll workers, and $500 per employee for continued noncompliance after being notified. Maryland does not presently have a provision for a penalty, but waives a $300 annual filing fee for participating employers.

Further guidance is expected from both the DOL and from each state that has enacted such a law. In addition, it is estimated that as many as 20 states are currently considering similar legislation.

Future *Eye on Washington* articles will report on this trend as other states adopt similar laws.

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