FINANCIAL SERVICES INSTITUTE

VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

January 19, 2016

Assistant Secretary Phyllis C. Borzi
Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
2000 Constitution Avenue, N.W.
Washington, D.C. 20210

Re: Notice of Request for Comments Regarding DOL's Proposed Regulatory Notice of Savings Arrangements Established by States for Non-Governmental Employees

Dear Assistant Secretary Borzi:

On November 18, 2015, the Department of Labor (DOL) published its request for public comment on a proposed regulation (Proposal) that would expand the current regulatory safe harbor within the Employee Retirement Income Security Act of 1974 (ERISA). The expanded safe harbor would apply to certain Individual Retirement Accounts (IRAs) which are excluded from the definition of "employee benefit plan[s]."[1] The proposal would add a safe harbor for state-run, auto-enrollment, payroll-deduction IRA programs, provided that employees are permitted to opt out of the participation in the program. For an IRA to qualify for the proposed safe harbor, it must: 1) be established by the state, [and] the state assumes responsibility for the security of the deductions, 2) the program does not impose any restrictions on withdrawals or impose any cost or penalty on transfers, and 3) all rights under the program are enforceable only by the employee. The proposal requires that an employer's participation be mandated by state law.

The Financial Services Institute (FSI) appreciates the opportunity to comment on this important proposal. FSI's members are strongly committed to working with all stakeholders to battle our country's emerging retirement crisis.[2] However, FSI believes the DOL's proposal will have unintended negative consequences for small businesses and states. The DOL's proposal will force employers, especially small employers, to overcome burdens related to the cost and time required to set up and administer a state-run retirement plan. Further, FSI believes that the DOL's proposal will open states to increased costs and liability. To avoid these unintended consequences, FSI recommends a marketplace-style plan similar to the plan instituted in Washington State, along with actively promoted financial literacy programs. We elaborate on these suggestions in our comments below.

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[1] Notice of Savings Arrangements Established by States for Non-Government Employees, *available at* http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=28542&AgencyId=8&DocumentType=1.

[2] The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the U.S., there are approximately 167,000 independent financial advisors, which account for approximately 64.5% producing registered representatives. These financial advisors are self-employed independent contractors, rather than employees of Independent Broker-Dealers (IBD).

FSI member firms provide business support to financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners who typically have strong ties to their communities and know their clients personally. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations and retirement plans with financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their investment goals.

Discussion

A. Overview of the DOL's Proposal

ERISA regulations provide a safe harbor for employers to assist employees in saving for retirement without having to sponsor an ERISA covered plan.[3] The safe harbor is applied if employer involvement is limited to: 1) administrative functions such as publicizing the program, collecting contributions and remitting them to the providers; 2) the employer does not make contributions or endorse the plan but instead acts as a mere facilitator of a relationship between the IRA vendor and employees; 3) the employer does not receive any consideration other than reasonable compensation for the services rendered; and 4) participation by employees is completely voluntary.[4]

The DOL's proposal would expand the safe harbor under which select payroll deduction plans would be excluded from the definition of an "employee benefit plan" as defined by ERISA.[5] The new safe harbor replaces the existing "completely voluntary" participation requirement with a "voluntary" requirement, in order to create an auto-enrollment feature.[6] The DOL's proposal lays out several factors that a state-run program must comply with in order to qualify for this safe harbor. The plan 1) must be established by a state pursuant to state law and be administered by the state or state agency; 2) the state agency is responsible for investing the employee savings or for selecting investment alternatives for employees to choose; 3) the state assumes responsibility for the security of the payroll deductions; 4) the program does not impose any restrictions on withdrawals or impose any cost or penalty on transfers or rollovers permitted under the Internal Revenue Code; and 5) all rights under the program are enforceable only by

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[3] *See generally,* 29 U.S.C. § 18, *available at*, https://www.law.cornell.edu/uscode/text/29/chapter-18
[4] Notice of Savings Arrangements Established by States for Non-Government Employees, *available at* http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=28542&AgencyId=8&DocumentType=1.
[5] Savings Arrangement Established by States for Non-Governmental Employees, 29 CFR Part 2510, *available at* https://www.gpo.gov/fdsys/pkg/FR-2015-11-18/pdf/2015-29426.pdf.
[6] *Id.*

the employee; former employee or beneficiary, an authorized representative of such a person or a state.[7] A program that meets these qualifications minimizes employer involvement and allows employees to control their participation.

B. <u>FSI is concerned that the DOL's proposal will lead to higher costs for small businesses and investors.</u>

FSI is concerned that the DOL's proposal could have serious negative consequences to small businesses. The DOL apparently shares this concern as they state in the proposal that "the costs that are incurred could fall most heavily on small and start-up companies, which tend to be least likely to offer pensions."[8] FSI believes there will be significant startup costs associated with creating a retirement savings plan and these costs will likely be passed on to plan participants. For example, Illinois stated that the costs of fees paid by employees will be charged up to 0.75 percent of the overall balances.[9] This fee is higher than those charged by private plans. In 2013, 401(k) plan participants who invested in equity mutual funds paid an average of 0.58 percent.[10] The DOL acknowledges that plan participants may eventually bear the expense of state start-up costs, stating "those workers least equipped to make good retirement savings decision stand to benefit most from state initiatives, but also arguably are most at risk of suffering adverse unintended effects."[11]

In addition to the costs passed onto plan participants, states may fine small businesses for noncompliance with an employer-mandated state-run retirement program. While the DOL's proposal does not specify any penalties, Illinois' state-run retirement system allows for a penalty for noncompliance in the first year of $250 per employee per year, which then increases to $500 for noncompliance per employee for each subsequent year.[12] For small businesses with already small profit margins, these punitive fines can further decrease margins. A small business could unintentionally violate the employer-mandate in a state-run retirement plan and incur these penalties, simply by not providing timely and specific disclosures.[13] FSI believes that the DOL's proposal will significantly increase costs and liabilities on small businesses and private employers. FSI believes these costs and liabilities can have serous negative consequences on small business across the country.

C. <u>FSI believes that the DOL understates the costs that the proposal will impose on states.</u>

In addition to the high costs associated with the DOL's proposal on small businesses, FSI believes that states will face considerable costs when attempting to establish an employer-mandated state-run retirement plan. In its proposal, the DOL describes few direct costs that will

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[7] *Id.*
[8] *Id.* at 21.
[9] Josh Barro, Illinois Introduces Automatic Retirement Savings Program, A First for the Nation, NY Times, Jan. 5, 2015, *available at* http://www.nytimes.com/2015/01/06/upshot/illinois-introduces-automatic-retirement-savings-program-a-first-for-the-nation.html?_r=1&abt=0002&abg=0.
[10] The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2013, ICI Research Perspective, Vol. 20 No. 3, July 2014, *available at* https://www.ici.org/pdf/per20-03.pdf.
[11]Notice of Savings Arrangements Established by States for Non-Government Employees, *available at* http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=28542&AgencyId=8&DocumentType=1 at 23.
[12] The Illinois Choice Savings Program Act, Pension Rights Center, *available at* http://www.pensionrights.org/issues/legislation/illinois-secure-choice-savings-program-act#sthash.76hz2aHm.dpuf.
[13] Expanding Access to Retirement Savings for Small Business, *available at*, https://www.blackrock.com/corporate/en-at/literature/whitepaper/viewpoint-expanding-access-retirement-savings-november-2015.pdf

be borne by states. However, as described below, states will face legal, administrative, and ongoing maintenance costs. The DOL describes legal costs to analyze the rule but estimates that these costs will be less than the savings generated for the state.[14] Further in its analysis, the DOL states that its review of existing state payroll deduction legislation shows that states would only incur "minor costs" to ensure conformance to the rule.[15] Because the DOL provides no cost-benefit analysis in this area and its assertion appears to be merely a hypothesis, it is impossible to determine what the costs will be. States relying upon the DOL's unsupported assertions about these costs may be unintentionally misled.

States that have conducted feasibility studies regarding the costs associated with employer-mandated state-run program have found start-up costs are likely higher than the DOL assumes in its proposal.[16] For instance, each state is likely to bear considerable administrative costs for tasks such as disseminating employee information packets, tracking employer compliance, enforcing the state statute, and assessing penalties on employers that fail to make the program available to its employees.[17] Not only is administration costly, but the ongoing maintenance of these state-run retirement plan is costly as well. In its feasibility study of a state-run program, California found a "program could cost $1.2 million in administrative and operating costs during the initial start-up years, not including marketing and advertising." [18] California stated that the mandatory enforcement aspect of the plan would result in "$465,000 in one-time costs for mailing and form production costs."[19] These administrative costs put additional pressures on states to achieve investment returns over and above what is guaranteed to be credited to employees' accounts in order to cover insurance premiums and overhead.[20] This is turn, could lead to the state boards charged with operating a state-run retirement plan making aggressive investment decisions in order to cover these costs.

The complexity and cost of running a state-run retirement plan is only exacerbated by the multiple, unrelated employers with vastly different human resources and payroll systems. A study by Maryland concluded that a state-run voluntary accounts program would require significant long-term state expenses, "[t]he vision of a State sponsored [plan] is to bring the benefits of large, well run [s]tate programs to a small business with 2 to 50 employees. The difficulty of this concept is that large businesses (government or others) already have their operating efficiencies built in: a single payroll center, a single data center, and recognized methods for contacting employees."[21] The disparity in individual small business recordkeeping systems and various processes would require increased efforts and costs by both small employers and the states.[22]

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[14] Notice of Savings Arrangements Established by States for Non-Government Employees, *available at* http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=28542&AgencyId=8&DocumentType=1
[15] *Id.*
[16] See *generally*, Retirement Savings Plans Fiscal Summary, Illinois SB 1234, *available at* http://www.usretirementfacts.com/wp-content/uploads/file/California%20SB-1234%20Department%20of%20Finance%20analysis.pdf and Voluntary Employee Accounts Program Study, Maryland Supplemental Requirement Plans, *available at* http://www.usretirementfacts.com/wp-content/uploads/file/Maryland%20Study%20-%202007.pdf.
[17] Illinois SB 1234 available at http://www.usretirementfacts.com/wp-content/uploads/file/California%20SB-1234%20Department%20of%20Finance%20analysis.pdf.
[18] Retirement Savings Plans Fiscal Summary, Illinois SB 1234, *available at* http://www.usretirementfacts.com/wp-content/uploads/file/California%20SB-1234%20Department%20of%20Finance%20analysis.pdf.
[19] *Id.*
[20] *Id.*
[21] Voluntary Employee Accounts Program Study, Maryland Supplemental Requirement Plans, *available at* http://www.usretirementfacts.com/wp-content/uploads/file/Maryland%20Study%20-%202007.pdf.
[22] *Id.*

FSI believes that the DOL understates the true cost to states of implementing a state-run retirement plan. As evidenced by the feasibility studies discussed above, states will face considerable legal, administrative, and maintenance costs in implementing a state-run retirement program. Further, the complexity and disparity between small business record keeping, some which may not be digital, will impose significant long term expenses to the state. These costs can be burdensome to states that are consistently struggling with budget deficits.

D. FSI believes that the DOL's proposal will lead to increased liability for states and may detrimentally affect plan participants' rights.

The DOL's intent to help average Americans save for retirement and to provide states a clear path to establishing retirement programs for workers employed by small employers is laudable. However, FSI believes that there are some serious logistical issues that are not addressed in the proposal that would create unintended negative consequences for a state-run retirement program. The proposal's unintended consequences do not end with ongoing expenses but include increased liabilities for the state and its taxpayers. The proposal specifically declares that a state is "to assume responsibility for the security of payroll deductions and employee savings."[23]

The proposal provides no additional information about what this responsibility means or requires. As state studies have determined, there is considerable liability associated with involvement with state-run retirement plans. According to a study by Maryland, states will have to plan for possible liabilities caused by financial entities.[24] Under the DOL's proposal, a state could incur liability if it fails to adequately supervise eligibility and sales practices that occur in a state-run retirement program.[25] Similarly, states are also liable for general accounting errors that occur in a state-run retirement plan.[26] As states undertake the task of building out state-run programs, it is inevitable they will run into occasional errors. Additionally states are liable for a general breach of their fiduciary duties such as their duty of loyalty and prudence to plan participants. This liability would occur when an individual is sold an improper investment unsuitable for theirs needs or if they received misleading communications about investments. These liabilities will lead to liabilities such as states being at serious risk of unfunded and unplanned liabilities if investment performance falters. Alternatively, for plans that would not, under the proposal, be subject to ERISA and its preemption provision, a state could disclaim liabilities as a matter of sovereign immunity. This would leave plan participants without legal remedies for improprieties in the state's administration of the plan.

Additionally IRA contribution limits are significantly lower than those applicable to 401(k) and other ERISA plans, which could result in individuals saving less through state-run programs. The DOL states that effective state initiatives would help workers save more but employees are able to save more when offered matching plans, which would not be allowed under this regulatory

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[23] Notice of Savings Arrangements Established by States for Non-Government Employees, *available at* http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=28542&AgencyId=8&DocumentType=1I at14.
[24] Voluntary Employee Accounts Program Study, Maryland Supplemental Requirement Plans, *available at* http://www.usretirementfacts.com/wp-content/uploads/file/Maryland%20Study%20-%202007.pdf.
[25] *Id.*
[26] *Id.*

framework.[27] These logistical issues left unanswered could impose serious consequences on the effectiveness of these plans.

E. FSI Supports the Marketplace-type Plan and believes that all stakeholders should further promote financial literacy.

FSI agrees with the DOL that more Americans must work to save for retirement. FSI believes that there are solutions available in the private marketplace, and that states can benefit by offering private market solutions. Therefore, FSI believes a marketplace-type plan best serves to provide access and education to employees about the plethora of retirement options already available to them.

The marketplace plan would establish a marketplace to connect eligible employers with retirement plans available in the private marketplace. This approach would allow each state to determine the criteria for provider participation. The state could select the providers that best suit the needs of their constituents. This is a better approach to more accurately meet the needs of employees at different stages in their planning. The DOL approach instead dictates one plan to meet everyone's needs. The marketplace approach would be completely voluntary and would offer both ERISA and non-ERISA savings plans. The marketplace approach would allow employers to offer matching campaigns ensuring that employees are able to maximize their savings.

Under the market place approach, a designated third party would assume responsibility for administrative and asset management functions. This is very different than requiring the state to administer and monitor the funds, imposing liability on the state. Instead, in this approach, the state could set up an online clearinghouse in which IRA providers authorized to conduct business in the state, could offer their programs, providing a one-stop shop for employees. State involvement would be limited to maintaining a website and selecting the providers. Employers could simply direct employees to the website. Certain materials could be provided by the state that would lower start-up costs to the employer without increasing liability risk to the state. FSI believes that this approach better achieves the goal of ensuring that individuals are aware of the options available to them that best suit their savings needs.

Conclusion

We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with the DOL on this and other important regulatory efforts. FSI believes that the creation of a marketplace plan could solve many of the retirement savings issues facing consumers today without the costs and liabilities associated with an employer-mandated plan.

Thank you for considering FSI's comments. Should you have any questions, please contact me at (202) 803-6061.

[27] Notice of Savings Arrangements Established by States for Non-Government Employees, *available at* http://webapps.dol.gov/FederalRegister/HtmlDisplay.aspx?DocId=28542&AgencyId=8&DocumentType=1

Respectfully submitted,

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