Department of Legislative Services

Maryland General Assembly
2016 Session

FISCAL AND POLICY NOTE
Enrolled - Revised

House Bill 1378 (Delegate Frick, *et al.*)
Economic Matters Budget and Taxation

Maryland Small Business Retirement Savings Program and Trust

This bill establishes the Maryland Small Business Retirement Savings Program and Trust, which requires specified private-sector employers to make the program available to their employees. Employers who participate in the program or otherwise offer a retirement savings arrangement to their employees as specified in the bill are exempt from the State's annual filing fee for corporations and business entities but only after the program becomes operational.

The bill takes effect July 1, 2016, but the program may not be implemented until the board obtains an opinion from legal counsel or from the federal government that the plan, trust, administrative arrangement, and investment offerings implemented under the bill qualify for favorable federal income tax treatment under the Internal Revenue Code.

Fiscal Summary

State Effect: General fund revenues decrease by as much as $37.1 million in FY 2018 due to specified employers being waived from paying the business filing fee; out-year revenue losses reflect 3% annual growth. If program implementation is delayed, the revenue effect is similarly delayed. General fund expenditures for the new program increase by $1.6 million in FY 2017 for staffing and start-up costs; out-year expenditures reflect annualization, inflation, and termination of one-time costs. To the extent that the program raises outside funds, these costs are mitigated. If the program secures a State loan, general fund expenditures remain, but they are paid back in future years. Expenditures cease in FY 2021, when the program is expected to be self-sustaining.

(in dollars)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
GF Revenue	$0	($37,080,000)	($38,192,400)	($39,338,200)	($40,518,300)
GF Expenditure	$1,579,800	$426,600	$440,000	$454,000	$0
Net Effect	($1,579,800)	($37,506,600)	($38,632,400)	($39,792,200)	($40,518,300)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: None.

Small Business Effect: Meaningful.

Analysis

Bill Summary:

Governance

The bill establishes the Maryland Small Business Retirement Savings Board to administer the trust and the program. It establishes staggered terms for specified members of the board, requires the board to designate a chair, and establishes conditions for removing members. All expenses, including employee costs, for the board are paid by the trust or program; however, administrative fees assessed on employee accounts to fund the program may not exceed 0.5% of total assets in the trust. Members of the board and its staff must (1) act solely in the interest of the program participants, as specified in the bill and (2) establish a written investment policy that includes a risk management and oversight program, as specified in the bill. The board must also enter into an agreement delegating the administration of the trust to a third-party administrator.

The board must adopt regulations and take any other action necessary to implement the program consistent with the federal Internal Revenue Code and ensure that the program meets the criteria for tax-deferral or tax-exempt status, or both. The bill establishes additional requirements and authority related to the board's administration of the trust and program, including, among other things:

- the authority to borrow funds from the State or any other entity for start-up costs until the board becomes self-sufficient;
- a requirement to establish a range of investment options, including a default option, that minimize the risk of significant investment losses and that are consistent with other specifications in the bill;
- a requirement to establish minimum and maximum employee contribution levels in accordance with federal limits on Individual Retirement Accounts (IRAs); and
- a requirement to take any action necessary to ensure that the program is not preempted by federal law.

The State may not be held liable for the payment of retirement savings benefits payable by the program or trust. The debts, contracts, and obligations of the board, trust, or program are not the debts, contracts, or obligations of the State, and neither the State's full faith and credit nor taxing powers are pledged directly or indirectly to the payment of the debts, contracts, and obligations. The State may not transfer assets in the trust to the general fund or any other State fund, nor can the State otherwise encumber assets in the trust. The board must conduct an annual audit by an independent certified public accountant and submit copies of the audit report to the Governor and General Assembly.

The board must establish procedures and disclosures to protect the interests of participants and employers. Before opening the program to enrollees, the board must design and disseminate information regarding the program to employers and employees. The information must include appropriate background and disclosures about the program and other retirement savings options, including information on how employees can opt out of the program.

Participation and Contributions

"Covered employers" are nongovernmental for-profit and nonprofit employers in the State that (1) pay employees through a payroll system or service; (2) have been in business for at least the last two years; and (3) do not currently offer, or have not offered in the previous two years, an employer-offered savings arrangement.

Employers may elect to establish alternative savings arrangements for their employees rather than participate in the program; participation in the program does not create a fiduciary obligation of the employers who do so. Specifically, employers are not liable for an employee's decision to participate or to opt out of the program or for their investment decisions, and they are not responsible for program design, administration, investment, or performance.

Generally, "covered employees" are those without access to an employer-sponsored retirement plan; they must also be at least age 18. After the board opens the program for enrollment, covered employers must establish a payroll deposit retirement savings arrangement that allows employee participation in the program. All covered employees must be automatically enrolled in the program by their covered employers, unless the employees have opted out; employees who have opted out may later enroll in accordance with procedures established by the board. Employees of nonparticipating employers may elect to participate in the program as authorized by the board. Any participating employees may terminate their participation at any time in a manner prescribed by the board.

The program consists only of one or more payroll deposit IRA arrangements. Unless otherwise specified by the employee, a participating employee contributes a fixed percentage or dollar amount of the employee's salary or wages to the program. By regulation, the board must set and may adjust the default employee contribution. The assets in a participating employee's account are the property of the employee.

Filing Fees

The bill waives the annual filing fee collected by the State Department of Assessments and Taxation (SDAT) for a corporation or business entity that participates in the program or otherwise offers a retirement savings arrangement for its employees, for the following reports:

- annual report of a Maryland corporation, except a charitable or benevolent institution, nonstock corporation, savings and loan corporation, credit union, family farm, and banking institution;
- annual report of a foreign corporation subject to the jurisdiction of the State, except a national banking association, savings and loan association, credit union, nonstock corporation, and charitable and benevolent institution;
- annual report of a Maryland savings and loan association, banking institution, or credit union, or of a foreign savings and loan association, national banking association, or credit union that is subject to the State's jurisdiction;
- annual report of a Maryland limited liability company, limited liability partnership, limited partnership, or of a foreign limited liability company, foreign limited liability partnership, or foreign limited partnership, except a family farm;
- annual report of a business trust;
- annual report of a real estate investment trust or foreign statutory trust doing business in the State; and
- annual report of a family farm.

The annual filing fee is $300, except that it is $100 for family farms.

Current Law: No State program provides retirement benefits to private-sector employees. The State Retirement and Pension System provides defined benefit (DB) pension plans to all State employees as a condition of their employment; plan participation is also available to local participating governmental units at the employer's discretion. The Maryland Supplemental Retirement Plans provide voluntary tax-preferred defined contribution (DC) plans to State employees. Neither program is available to private-sector employees.

In general, the federal Employee Retirement Income Security Act (ERISA) preempts states' authority to regulate employer-provided benefit plans, including retirement savings plans.

Background:

Access to Employer-based Retirement Plans

Beginning in the 1980s and accelerating through the 1990s, workers' access to DB pension plans dropped considerably. According to the Center for Retirement Research (CRR) at Boston College, the share of employees with at least a DB pension plan dropped from 88% in 1983 to just 32% in 2010. The trend was most pronounced in the private sector, as most public employers have retained their DB plans. In most cases, DB plans were replaced by DC plans, with coverage from DC plans growing from 38% in 1983 to 81% in 2010 (these figures include workers covered by both types of plans).

DC plans place both the investment risk and the burden to contribute enough money on the employee rather than the employer, and research concludes that the current generation that is approaching retirement has not set aside sufficient resources to provide a comfortable and secure retirement. CRR's National Retirement Risk Index, which measures the percent of households at risk for falling more than 10% below the amount they need for a secure retirement, has been steadily rising since 1992. Most recently, the index rose from 44% in 2007, just before the Great Recession, to 53% in 2010. This is the first time that the index has shown that more than one-half of all Americans are at risk of outliving their retirement savings.

In the private sector, the lack of retirement savings stems in part both from lack of access and from low participation rates for DC plans. According to the U.S. Department of Labor, only 66% of private-sector employees have access to either a DB or DC plan sponsored by their employer. Among the relatively low number (18%) with access to a DB plan, 84% participate. However, among those with access to a DC plan (61%), only 71% participate. Even among those that do participate in a DC plan, however, there is no guarantee that they contribute sufficient savings during their working years to ensure a secure retirement (and the research has shown that they do not). Access to any employer-based retirement plan is even lower for low-wage workers and those who work for small businesses. Only 40% of low-wage workers have access to work-based retirement savings plans, and 46% of employees who work for businesses with fewer than 50 employees have access.

Federal and State Action

Several states have enacted legislation that seeks to expand access to employer-based retirement savings options, including some that are similar to this bill. In 2012, California enacted Chapter 734, the California Secure Choice Retirement Savings Trust Act. Under Chapter 734, implementation of the California program was contingent on a market analysis concluding that the program can be self-sustaining; the market analysis has been completed, and the board is moving toward making a recommendation for implementation to the state legislature. The California board was required to raise private funds for all start-up costs; almost all of the $1.0 million raised has been spent on planning activities.

In January 2015, Illinois enacted the Illinois Secure Choice Savings Program, which requires Illinois businesses that have operated for at least two years, that employ at least 25 employees, and that have not offered a qualified retirement plan in the preceding two years to participate in the program. Employees of participating employers must contribute 3% of their compensation to a pooled IRA, unless they opt out of the program. The program's operations are paid from fees drawn from trust assets, but total administrative costs cannot exceed 0.75% of total assets held in the trust. Illinois is authorized to pay the program's start-up costs until there are sufficient assets in the trust to cover their cost.

Since then, Washington, Oregon, and New Jersey have enacted legislation. Oregon's approach is similar to California and Illinois, but Washington and New Jersey opted for market-based approaches through the establishment of retirement savings exchanges that connect small businesses to approved investment vehicles. None of the programs in the five states is actually operational, but several expect to begin operations by 2017.

In January 2014, President Obama announced he was establishing a MyRA program. Similar to IRAs, MyRAs allow employees to deduct a portion of their pay to be deposited into an account invested in U.S. government bonds; earnings in those accounts accrue tax free. The program is available to individuals with annual household incomes up to $191,000 whose employers elect to participate.

In November 2015, the U.S. Department of Labor (DOL) issued proposed regulations and an interpretive bulletin to clarify the status of state-run retirement savings plans with respect to ERISA. The proposed regulations clarify that auto-enrollment IRA plans do not constitute an employer benefit plan under ERISA and, therefore, are not subject to preemption, as long as they meet several criteria. Among the most important criteria are:

- participation by employers is mandatory;
- participation by employees is voluntary – if auto enrollment is used, employees must have the ability to opt out;
- the plan is administered by a state, either directly or through a private-sector vendor; and
- the role of employers must be limited to ministerial activities such as collecting payroll deductions and remitting them to the program. Employer contributions to the IRAs are not allowed.

The period for public comment on the proposed regulations has closed, and DOL is assessing the comments it received. The interpretive bulletin provides guidance to states on establishing ERISA-covered plans, including market-based exchanges and multi-employer plans, which are accessible to private employers.

State Revenues: In 2014, SDAT collected $82.5 million from the annual report filing fee, which is estimated to grow to approximately $90 million by 2017. In a 2013 survey of its members, the National Small Business Association found that 40% of its members use a payroll system or service to pay their employees. This is relatively consistent with an estimate of 33% of employers provided by the National Payroll Reporting Consortium. Therefore, for the purpose of this analysis, the Department of Legislative Services (DLS) assumes that 40% of Maryland businesses become exempt from the report filing fee under the bill. As the program is not expected to become operational until fiscal 2018, general fund revenues decrease by as much as $37.1 million in fiscal 2018 and by increasing amounts in future years, which reflects 3% annual growth on an ongoing basis.

State Expenditures: The bill specifies that all expenses to implement, maintain, and administer the program and the trust must be paid from money collected by or for the program or trust. However, before the program becomes operational, it will incur significant expenses that cannot be paid from the 0.5% administrative fee allowed by the bill because the program will not have any assets. At a minimum, based on the activities of similar programs in other states, the program must, before it becomes operational:

- secure legal counsel with expertise in ERISA to ensure that it complies fully with federal law and regulations, and to file petitions with the Internal Revenue Service to determine whether it qualifies for favorable tax treatment;
- hire staff to support and advise the board;
- conduct market and financial feasibility studies to determine an optimal program design, financing model, and risk management strategy; and
- distribute information to employees and employers.

Each state that has taken steps to either implement or study a program has taken a different approach to funding these start-up activities. California's statute prohibited the use of state funds for legal and market analyses, so the Secure Choice Board spent two years raising $1.0 million from private and nonprofit sources. It began spending those funds in 2015 and advises that it has nearly exhausted them. Oregon received a loan of nearly $1.0 million from the state, which it, too, has nearly exhausted. Connecticut's Retirement Security Board, which has been studying the feasibility of establishing the program but does not yet have legislative authorization to implement a program, raised $1.1 million from private sources, and it has incurred costs of all but $40,000 in about a year. DLS notes that in some cases these expenditure amounts are understated because each program has used in-kind staff support from its state treasurer’s office and/or other agencies, so direct staff costs have been minimized.

The Maryland Small Business Retirement Savings Board established by the bill has the option of raising private funds to support program start-up, as was done in California and Connecticut, or to borrow money from the State, as was done in Oregon. The former option would certainly delay implementation of the program, as raising the funds would be a time-consuming pursuit. Alternatively, the board could pursue a loan from the State, which would have to be paid back when the program becomes operational and, thus, delay the program’s ability to become self-sufficient. In lieu of pursuing either of these two strategies, this analysis assumes that general fund expenditures increase by $1,579,819 in fiscal 2017 for start-up costs, which accounts for a 90-day delay from the bill’s July 1, 2016 effective date. This reflects hiring an executive director, a policy director, a chief financial officer, and an administrative assistant to support and advise the board on program design. It includes salaries, fringe benefits, one-time start-up costs, operating expenses, and the cost of outside legal counsel, a market/feasibility study, and production costs for the distribution of information to employees and employers.

Positions	4.0
Salaries and Fringe Benefits	$253,961
Legal Counsel	350,000
Feasibility Study	750,000
Information Distribution	200,000
Other Operating Expenses	25,858
Total FY 2017 State Expenditures	**$1,579,819**

Future year expenditures reflect full salaries with annual increases and employee turnover as well as annual increases in ongoing operating expenses. The feasibility study is a one-time expense, but DLS anticipates ongoing legal expenses of $50,000 and information distribution costs of $25,000 annually. It is anticipated that the program becomes operational in 18 months and has sufficient assets to be self-supporting after less than three years of operation. Therefore, there are no State expenses in fiscal 2021.

Although the bill requires the board to enter into an agreement delegating administration of the trust to a third-party administrator, the cost to do so is not reflected above. Any such cost would be covered by the 0.5% administrative fee.

Small Business Effect: Small businesses that use a payroll system or service must establish a payroll deduction for employees who wish to contribute to the savings arrangement or otherwise offer a retirement savings arrangement to their employees. Employer contributions are not allowed by the bill, so there is no additional cost to employers, and employers are not considered fiduciaries under the bill, so there is no liability for them either.

Small businesses that comply with the bill or otherwise offer a savings arrangement to their employees no longer have to pay the annual $300 filing fee.

Additional Information

Prior Introductions: None.

Cross File: SB 1007 (Senator Peters, *et al.*) - Budget and Taxation and Finance.

Information Source(s): State Department of Assessments and Taxation, California Secure Choice Retirement Savings Investment Board, Connecticut Retirement Security Board, Oregon Retirement Savings Plan, Georgetown Center for Retirement Initiatives, Bureau of Labor Statistics, Boston College Center for Retirement Research, National Small Business Association, National Payroll Reporting Consortium, Comptroller's Office, U.S. Department of Labor, Department of Legislative Services

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Analysis by: Michael C. Rubenstein

Direct Inquiries to:
(410) 946-5510
(301) 970-5510