

Prepared by The Wagner Law Group

# THE IMPACT OF 'NEXT GENERATION' IRAs:

## myRA<sup>®</sup> Accounts, EZ IRA<sup>®</sup> and State-Mandated IRAs



Understanding the benefits and differences in these IRA-based initiatives for the workplace.

Important note: The Wagner Law Group has prepared this white paper on behalf of Legg Mason & Co., LLC. This paper includes a discussion of certain types of individual retirement accounts (IRAs) and payroll deduction arrangements that use IRAs as retirement savings vehicles. Employers and employees should consult with their own legal counsel concerning the tax benefits of IRAs and payroll deduction arrangements, as well as their related requirements and restrictions.

Future legislative or regulatory developments may significantly impact the matters discussed in this paper. Please be sure to consult with your own legal counsel concerning the application of any applicable federal law, state law and tax rules to IRAs and payroll deduction arrangements, and any related future developments.

This white paper is intended for general informational purposes only, and it does not constitute legal, tax or investment advice on the part of The Wagner Law Group, Legg Mason & Co., LLC and its affiliates, iVEZT, LLC, or your retirement or payroll service provider.

The EZ IRA program is a payroll deduction IRA program sponsored by iVEZT, LLC. An affiliate of Legg Mason, Inc. has a 30% ownership interest in iVEZT, LLC. The investment options available under the EZ IRA program are comprised exclusively of Legg Mason mutual funds, which are offered through Legg Mason Investor Services, LLC. Before investing, carefully consider a fund's investment objectives, risks, charges and expenses. You can find this and other information in each prospectus, and summary prospectus, if available, at [www.leggmason.com/individualinvestors](http://www.leggmason.com/individualinvestors). Please read the prospectus carefully.

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**For more information on EZ IRA, visit [www.ezira.com](http://www.ezira.com).**

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# INTRODUCTION

There are approximately 68 million workers in America who do not have access to an employer-sponsored retirement plan, such as a 401(k) or 403(b) plan.<sup>1</sup>

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Both investment product developers and government policymakers appear to believe that individual retirement accounts (IRAs) can and will play a pivotal role in bridging this gap for millions of Americans. New types of payroll deduction IRA programs are being developed for workers who are currently unable to contribute to a retirement plan through their workplace. In addition to the private-sector innovation in this area, the public sector has also been developing new payroll IRA-based initiatives.

Given the critical role that IRAs have in wealth management and retirement planning, it is important for employers as well as retirement and payroll service providers to educate themselves on these next-generation IRAs. With a more complete understanding of these new types of payroll IRA programs, employers will be able to make informed decisions when selecting an appropriate retirement savings vehicle for their employees, and providers will be able to offer up-to-date guidance to them.

<sup>1</sup> U.S. Department of Labor, EBSA Fact Sheet: State Savings Programs for Non-Government Employees (Nov. 16, 2015).

# FOCUSING ON PAYROLL IRAs

Much of the IRA-related innovation in recent years has focused on payroll deduction IRAs, which are also simply called "payroll IRAs." When an employee is interested in contributing to a payroll IRA, he or she will typically establish an IRA with a financial institution and then ask the employer to help coordinate payroll deductions.



In other instances, the employer will select an IRA provider, and then make the provider's payroll IRA program available as a convenience to all employees.

There are many employers that are willing to establish a tax-qualified retirement plan, such as a 401(k) or 403(b) plan, for the benefit of their workforce. But some employers may be unwilling to assume the responsibilities that go along with being a plan sponsor. There is a significant amount of work and potential cost associated with operating a tax-qualified plan, which is subject to numerous requirements under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). A plan sponsor is also subject to potential fiduciary liability in the event the plan or its investments are mismanaged to the detriment of the plan's participants.

Fortunately, there is a way for employers that do not want to become ERISA plan sponsors to help their employees save for retirement on a tax-favored basis. There is a "safe harbor" exclusion from ERISA for employers that make payroll IRAs available to their employees.<sup>2</sup> As long as the employer's involvement in the payroll IRA arrangement is limited, the IRAs and the overall arrangement will not become subject to ERISA and the employer will not be viewed as an ERISA fiduciary. To qualify for this safe harbor exclusion, the employer must not endorse the IRA arrangement and its available investment options, and employee participation must be completely voluntary. Additionally, the employer must not make any contributions to any IRAs, and the employer generally must not receive any payment from the financial institution offering the IRAs.

Employers generally want to help their workers save for retirement, and payroll IRAs are an elegant solution for those that do not want to accept the ERISA-related duties of managing a full-blown retirement plan. For these reasons, the financial services industry has been developing new payroll IRA products that are designed to serve the needs of employers that do not want to sponsor a 401(k) or 403(b) plan. As a public policy matter, the federal government and various states have also recognized the potential benefits of payroll IRAs and how they may be used to improve the retirement security of millions of workers. As a result, payroll IRA-based initiatives are in the process of being rolled out by certain state governments. Such initiatives are specifically designed to help employees without access to employer-sponsored retirement plans.

<sup>2</sup> 29 CFR 2510.3-2(d), Individual Retirement Accounts. See, also, DOL Interpretive Bulletin 99-1.

# OVERVIEW OF 'NEXT-GENERATION' IRAs

The federal government and the states as well as the private sector are developing new types of payroll IRA programs to help employees save for their retirement.



## Federal government: myRA accounts

The myRA is a new type of payroll IRA that is available through the U.S. Treasury Department. It was launched nationwide on November 4, 2015. The myRA, which stands for “my Retirement Account,” is not designed to replace a 401(k) or 403(b) plan. Instead, it is intended to serve as a starter savings account for new investors who may only be able to save modest amounts in their current circumstances. In fact, a myRA is subject to a maximum account value of \$15,000.<sup>3</sup> Once this dollar ceiling is reached, the account needs to be rolled over to a private-sector Roth IRA.

There is no minimum amount for payroll contributions to a myRA. For example, contributions may be as small as \$2 per pay period. All assets of a myRA account must be invested in a special U.S. Treasury bond that was created expressly for the myRA program. The bond automatically matures when the account value reaches \$15,000 or after 30 years, whichever comes first. The bond is guaranteed by the full faith and credit of the U.S. government. There are no investment fees or administrative costs associated with opening or maintaining a myRA account. The myRA is also portable and owned by the contributing individual, and not the employer.

For tax purposes, a myRA is simply a Roth IRA, and it is subject to the same income and contribution limits. To be able to contribute to a myRA or any other Roth IRA for 2016, an individual generally must earn less than \$132,000 (or \$194,000 in the case of those who are married filing jointly). The standard contribution limit for a myRA or any other Roth IRA for 2016 is \$5,500, and the catch-up limit for those who have attained age 50 is \$6,500.<sup>4</sup>

## Private sector: EZ IRA and similar payroll IRA programs

Many IRA owners view mutual funds as the investment of choice for their accounts. As a historical matter, IRA owners were generally only able to access the “retail” share classes of mutual funds, such as A shares. These share classes are commonly used for IRA investors whose IRA accounts are maintained on a brokerage platform, and they customarily feature a sales load. Because the sales load is typically a one-time charge, this kind of compensation arrangement may be well-suited for retirement clients that make one-off purchases for their investment accounts.

In the past, payroll IRA owners were typically treated like regular IRA owners for share class purposes. Thus, payroll IRA owners had to invest in regular retail shares and pay recurring sale loads on fund shares that were purchased with each new payroll contribution. If a payroll IRA owner wished to avoid paying recurring sales loads, they could always choose to invest in a no-load fund, rather than a fund with a sales load. However, since no-load funds do not pay any commission-based compensation, fewer financial advisors would be willing to work with the payroll IRA owner. In the end, payroll IRA owners were faced with a difficult decision, having to choose between paying recurring sales loads or passing up the opportunity to work with commission-based advisors.

The good news is that as a result of innovative developments in the private sector, employees who establish payroll IRAs can now enjoy the same share class pricing that is available to participants in employer-sponsored retirement plans. An example of an innovative payroll IRA program is iVEZT’s EZ IRA program. Under the EZ IRA program, employees have the choice of making payroll contributions to either a Traditional or Roth IRA. The program is administered by a separate recordkeeper, and employees who establish payroll IRAs may access the R shares of a number of Legg Mason funds, which do not have a sales load. Alternatively, employees who work with a registered investment adviser may access an institutional share class of the same funds, which similarly do not have a sales load.

<sup>3</sup> 79 FR 74023.

<sup>4</sup> The 2016 contribution limit is reduced for single filers earning more than \$117,000 and fully phased out at \$132,000. It is also reduced for married filers earning more than \$184,000 and fully phased out at \$194,000.

The EZ IRA program is an advisor-supported program, and those employees who establish a payroll IRA will have the opportunity to work with a financial advisor. Although there is no sales load, R shares feature 12b-1 fees that are used to compensate advisors.

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In the case of institutional shares, there is no 12b-1 fee or sales load, but the registered investment adviser may charge a fee directly for its services. Investors should keep in mind that the absence of a sales load does not necessarily mean that the funds are superior to other investments with sales loads. With regard to both R shares and institutional shares, in addition to fund expenses, the employee may bear certain administrative and IRA-related fees.

#### **State governments: State-mandated IRA programs** (pending)

Given the public policy interest in promoting retirement savings, dozens of states are exploring different types of retirement initiatives. A small but growing number of states have already enacted legislation that has been formally signed into law. For example, Washington has enacted a state law requiring the government to establish a “marketplace” that would give small businesses access to state-approved vendors of retirement plans, payroll IRAs and other similar programs.<sup>5</sup> An employer’s participation in the marketplace would be voluntary, and the state itself would not sponsor or administer any retirement programs.

Other states, such as California, Illinois and Oregon, have taken a more hands-on approach, enacting laws that actually require the government to develop a state-administered payroll IRA program.<sup>6</sup> Although the rules vary, these state-based initiatives adhere to the same basic approach. The state would be in charge of managing the IRA program as well as the investment options available to payroll IRA owners. Once the state’s IRA program is finalized and launched, participation in the program would be mandatory for all covered employers that do not sponsor their own retirement program for their employees. All but the smallest of employers would be covered by the mandate. For example, in California, only employers with less than five employees would be exempt.

Furthermore, once the state’s IRA program is rolled out, all employees of a covered employer would need to be automatically enrolled in the state’s payroll IRA program. Payroll contributions would automatically commence, unless the employee affirmatively opts out. The type of payroll IRA that would be offered under the state’s program, which would be either a Traditional or Roth IRA, would be dictated by the particular provisions of the relevant statute.

<sup>5</sup> 2015 Wash. Sess. Laws chap. 296 (SB 5826).

<sup>6</sup> California Secure Choice Retirement Savings Act (2012 Cal. Legis. Serv. Ch. 734), Illinois Secure Choice Savings Program Act (2014 Ill. Legis. Serv. P.A. 98-1150), and Oregon 2015 Session Laws, Ch. 557.

# THE IMPACT OF 'NEXT-GENERATION' IRAs

The IRA marketplace is undergoing considerable change as a result of these new initiatives, which include the federal government's myRA accounts, private-sector payroll IRA programs like the EZ IRA, and the various state-mandated IRA programs that are being developed.



Each of these next-generation IRAs are actually Traditional or Roth IRAs for tax purposes, but they have additional “bells and whistles” that are designed to promote their adoption by small businesses for the convenience of their workers.

## **Utilization of myRA accounts by novice investors**

The government's myRA program is designed to appeal to workers who are looking for a starter savings account without a fee. myRA accounts lack the flexibility necessary to serve as lifetime savings vehicles; they are intended to serve as transitional accounts for novice investors. By way of illustration, myRA accounts cannot hold any equity investments, and the account must be rolled over to a private-sector Roth IRA once it reaches a maximum value of \$15,000.

Given the transitional nature of a myRA account and the fact that its target audience is comprised of novice investors, individuals with a high net worth will presumably have little interest in participating in the myRA program. On the other hand, myRA accounts may be well-suited for individuals who are younger or who have little or no retirement savings. More information about the myRA program is available at its website at [www.myra.gov](http://www.myra.gov).

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## **EZ IRA and similar payroll IRA programs for small businesses**

The EZ IRA is a private-sector payroll IRA program that may be beneficial for both small businesses and their workers. From the employer's perspective, the program gives the employer the ability to offer a valuable employee benefit without becoming subject to the fiduciary requirements of ERISA. Unlike 401(k) plans and other employer-sponsored plans, payroll IRAs are relatively easy to administer. There is no need to perform any IRS discrimination tests or file annual returns on the Form 5500. The employer merely needs to refrain from endorsing the payroll IRAs to its employees, and it must otherwise limit its involvement in the IRA program.

From the employees' perspective, one of the best features of the EZ IRA program is that they are able to get personalized investment assistance from a financial advisor. Although there is a cost associated with working with a financial advisor (i.e., 12b-1 fees or advisory fees charged by a registered investment adviser), a qualified advisor can help employees save for retirement in a disciplined way and choose suitable investments based on their preferences and risk profile. The EZ IRA program utilizes the same share class pricing that is available to 401(k) and 403(b) plans, making this payroll IRA program similar to the kinds of employer-sponsored retirement plans that are widely supported by financial advisors. Additionally, employees do not have to worry about triggering sales loads as additional fund shares are purchased through payroll contributions.

The EZ IRA is designed to provide a solution for small businesses that do not sponsor a tax-qualified retirement plan. If payroll IRAs were established by just a small percentage of the millions of workers who do not have access to a retirement plan, private-sector IRA programs like EZ IRA would gain even further traction, and they may become as commonplace as 401(k) and 403(b) plans. Small businesses that do not currently sponsor a retirement plan may wish to consider discussing the benefits and features of the EZ IRA program with their retirement or payroll service providers.

## **Opportunities created by state-mandated IRA programs**

As discussed, a small but growing number of states have enacted laws that would require the development of a state-administered payroll IRA program. Once a state's program is finalized and launched, participation would be mandatory for covered employers. However, they would not be subject to the state's mandate to the extent that they adopt their own retirement plans or programs for their employees. Accordingly, rather than offering the state-administered IRA program, employers could choose to investigate other alternatives, such as tax-qualified plans or private-sector IRA programs.

As a result of these types of state mandates, affected employers may be more receptive to the idea of establishing their own retirement plan or payroll IRA program. Employers should consult their legal counsel to determine whether and when they might become subject to a state mandate, and to confirm how the mandate may be avoided by setting up their own retirement plan or program.

# CONCLUSIONS

The next generation of payroll IRAs is being developed with the important goal of improving the retirement security of millions of American workers who do not currently have access to an employer-sponsored retirement plan.



- 1** The federal government's myRA accounts are geared toward workers who are novice investors who may only be able to set aside and save modest amounts for their retirement. When the account reaches a value of \$15,000, it will need to be rolled over to a private-sector Roth IRA.
- 2** Certain new private-sector payroll IRA programs, such as iVEZT's EZ IRA program, feature mutual funds with the same share class pricing that is available to participants in employer-sponsored retirement plans. These programs are designed to give employees the opportunity to work with financial advisors.
- 3** State-mandated IRA programs, once they are finalized and launched, will require covered employers to offer the program to their employees. But employers may wish to consider setting up their own retirement plan or program instead of offering state-administered IRAs.

Attached is a "Next-Generation" Payroll IRA Comparison and Questionnaire with a summary of these new payroll IRA programs and initiatives. These new IRA arrangements are likely to have a growing impact on small businesses in the future, and business owners should strongly consider discussing the benefits and requirements of these new payroll IRAs with their retirement or payroll service provider.

# EXHIBIT A

## 'Next-Generation' Payroll IRA Comparison and Questionnaire

Comparison of next-generation payroll IRAs			
	myRA accounts	EZ IRA and similar payroll IRA programs	State-mandated IRAs (pending)
Personal support from financial advisor	Not available	Employees would be able to work with financial advisors 	Awaiting rollout from various states
Range of investment choices	Assets must be invested in a special Treasury bond for myRAs	Under the EZ IRA program, assets may be invested across a range of Legg Mason funds 	Awaiting rollout from various states
Lifetime savings vehicle	Once a maximum value of \$15,000 is reached, it must be transferred to a Roth IRA	There is no maximum value 	Awaiting rollout from various states
Vehicle for beginner investors	myRAs are intended as starter savings accounts for novice investors 	EZ IRA and other similar programs may be used by many types of investors 	Awaiting rollout from various states

Important information: The information in this "Next Generation" Payroll IRA Comparison and Questionnaire is general in nature and does not constitute legal, tax or investment advice on the part of The Wagner Law Group, Legg Mason & Co., LLC and its affiliates, iVEZT, LLC, or your retirement or payroll service provider.

## Next-generation payroll IRA questionnaire

Workforce needs	Next-generation payroll IRA program	Yes/No
<p><b>Beginner investors</b></p> <p>Is your average employee a novice investor who is only able to save a small amount each pay period for retirement (e.g., \$25)?</p>	<p><b>myRA accounts</b></p> <p>If the answer is yes, you may wish to consider making the federal government's myRA accounts available as payroll IRAs for your employees.</p> <ul style="list-style-type: none"> <li>• <b>Roth IRA.</b> myRA accounts are a special type of Roth IRA, and this program is administered by the U.S. Treasury Department.</li> <li>• <b>Treasury bonds.</b> Employees make payroll contributions to their myRA accounts, which must be invested in a special Treasury bond created for this program. There are no minimum investments (e.g., \$2 per pay period would be permitted).</li> <li>• <b>Maximum value.</b> Once the account reaches a maximum value of \$15,000, it will need to be transferred to a private-sector Roth IRA.</li> <li>• <b>No fees.</b> There are no administrative costs or investment fees for myRA accounts.</li> </ul>	<input type="checkbox"/> <input type="checkbox"/>
<p><b>Advisor assistance</b></p> <p>Would it be beneficial for your employees to work with a financial advisor to help them save for retirement?</p>	<p><b>EZ IRA and similar payroll IRA programs</b></p> <p>If the answer is yes, you may wish to consider making the EZ IRA program or other similar private-sector programs for payroll IRAs available to your employees.</p> <ul style="list-style-type: none"> <li>• <b>Choice of IRA type.</b> Employees may elect to establish a Traditional or Roth IRA, and make payroll contributions to their IRA.</li> <li>• <b>Special Share Class.</b> EZ IRA investors can invest in a retirement or institutional share class of Legg Mason funds, which is ordinarily not available to regular IRA investors.</li> <li>• <b>Financial Advisor.</b> Employees would be able to work with financial advisors, who are compensated through the applicable fund's 12b-1 fee or by an advisory fee charged directly to the client. However, no sales load would be incurred on fund share purchases.</li> </ul>	<input type="checkbox"/> <input type="checkbox"/>
<p><b>No retirement program</b></p> <p>Do your employees lack the ability to save on a tax-favored basis through a retirement program?</p>	<p><b>EZ IRA and similar payroll IRA programs, and state-mandated IRAs (pending)</b></p> <p>If the answer is yes, you may wish to consider making the EZ IRA or other similar private-sector programs for payroll IRAs available for your employees. You should also investigate whether your state has enacted a law requiring it to develop state-administered payroll IRAs.</p> <ul style="list-style-type: none"> <li>• <b>State law.</b> A small but growing number of states have enacted laws requiring the creation of a state-administered IRA program (e.g., California, Illinois and Oregon).</li> <li>• <b>Mandate.</b> Once a state's IRA program is finalized and launched, participation would be mandatory for covered employers without retirement programs for their own employees.</li> <li>• <b>Counsel.</b> Consult legal counsel to see if you are subject to any state mandate, and how you may be able to avoid this mandate by setting up your own retirement program.</li> </ul>	<input type="checkbox"/> <input type="checkbox"/>

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For more information on EZ IRA, visit [www.ezira.com](http://www.ezira.com).

For use with R-share and I-share funds.

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### About Marcia Wagner and The Wagner Law Group

Marcia S. Wagner is a specialist in pension and employee benefits law, and she is the principal of The Wagner Law Group, one of the nation's largest boutique law firms, specializing in ERISA, employee benefits and executive compensation, which she founded over 20 years ago.

A summa cum laude and Phi Beta Kappa graduate of Cornell University and a graduate of Harvard Law School, she has practiced law for over 29 years. Ms. Wagner is recognized as an expert in a variety of employee benefits issues and executive compensation matters, including qualified and non-qualified retirement plans, all forms of deferred compensation, and welfare benefit arrangements.

Ms. Wagner was appointed to the IRS Tax Exempt & Government Entities Advisory Committee and ended her three-year term as the Chair of its Employee Plans subcommittee, and received the IRS' Commissioner's Award. Ms. Wagner has also been inducted as a Fellow of the American College of Employee Benefits Counsel.

For the past eight years, *401k Wire* has listed Ms. Wagner as one of its 100 Most Influential Persons in the 401(k) industry, and she has received the Top Women of Law Award in Massachusetts and is listed among the Top 25 Attorneys in New England by *Boston Business Journal*. Ms. Wagner has written hundreds of articles and 14 books about retirement and benefit plans. Ms. Wagner is widely quoted in business publications such as *The Wall Street Journal*, *Financial Times*, *Pensions & Investments* and more, as well as being a frequent guest on FOX Business, CNN, Bloomberg, NBC and other televised media outlets.

**All investments involve risk, including loss of principal.**

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