Pooled Employer Plans (PEPs)

Encourage savings, reduce work, maximize fiduciary protections

There are over 30 million small businesses in the United States that employ 47.3% of the private workforce, and those numbers are growing.[1] During this time, people have become more dependent on employer-sponsored retirement plans, such as 401(k) plans, to fund their retirement. These factors are fueling a looming retirement crisis because, as a recent study noted, just 63% of businesses with 25–49 employees offer retirement savings plans, just 51% of businesses with 10–24 employees offer plans, and only 28% of businesses with fewer than 10 employees provide a plan.[2] Start-up costs and ongoing administrative burdens were the primary reasons employers identified for not offering plans.[3] Even larger employers, as well as many small employers that offer plans, have neither the time, staff nor expertise to devote to a plan and still look to outsource fiduciary and administrative duties.[4]

A unique solution to tackle this problem can be found in a new type of plan called a Pooled Employer Plan (PEP). While Multiple Employer Plans (MEPs) have been around for many years, MEPs did not enjoy broad adoption. MEPs have been viewed by many employers as confusing and risky. However, the creation of PEPs by the *Setting Every Community Up for Retirement Enhancement Act of 2019* (SECURE Act) should make unrelated employers participating in a single plan more accessible and attractive to employers and encourage them to sponsor retirement savings plans.

1. *Small Businesses Drive Job Growth in United States*, U.S. Small Business Administration, Office of Advocacy (Apr 24, 2019).

2. Weston, Bridget, *Why Entrepreneurs Should Be Saving for Retirement, SCORE.org* (August 11, 2019).

3. Ibid.

4. Moore, Rebecca, *The Plan Sponsor Time Crunch*, Plansponsor.com (September 15, 2020) (“approximately half of plan sponsors said they spend less time than they would like on their retirement plans, according to a poll by Mercer”).

Background on retirement plans

Sponsoring retirement plans presents challenges to employers, particularly to those that have neither the financial nor human capital resources to meet those challenges. For example, under the *Employee Retirement Income Security Act of 1974* (ERISA), an employer that adopts a qualified retirement plan typically takes on the fiduciary responsibilities of the "named fiduciary," with overall responsibility for the plan, and the "ERISA plan administrator," which is sometimes referred to as an ERISA 3(16) fiduciary.[5] These responsibilities can include:

- selecting plan design features
- executing a written plan document to establish the plan
- engaging multiple service providers to assist with plan operations
- selecting the menu of investments, including monitoring and adjusting the investment options
- communicating plan information and educational materials to employees
- making timely deposits of employee deferrals into the plan
- authorizing distributions
- filing an annual Form 5500, if applicable

Fiduciaries are held to high standards of conduct under ERISA and can be found personally liable for breaching their responsibilities. This can be daunting, particularly for employers that do not have the in-house capacity, skill or time to carry out these functions. Smaller employers can also face higher plan costs and more limited access to investment products because smaller plan balances mean less bargaining power with third-party providers when negotiating fees or gaining access to investment options.[6] For some employers, PEPs may provide a solution to these challenges.

5. Employee Retirement Income Security Act, 29 CFR § 2510.3-16 (1974).

6. Registration Requirements for Pooled Plan Providers, 29 C.F.R. Part 2510, DOL, EBSA (Nov. 12, 2020) (small plans with 10 participants pay approximately 50 bps more than plans with 1,000 participants and 90 bps more than plans with 50,000 participants).

History of MEPs

The Internal Revenue Service (IRS) and Department of Labor (DOL) recognize MEPs as 401(k) plans in which groups of companies unrelated for internal revenue code purposes elect to participate in a single plan. Thus, unlike traditional single-employer plans that are designed to cover the employees of one business or a group of businesses with common ownership interests, MEPs are designed to cover the employees of many different employers.

In theory, MEPs should appeal to employers seeking economies of scale regarding plan administration and investment costs, but the following regulations from the IRS and DOL have resulted in low adoption rates for MEP 401(k) plans:

Commonality requirement	To participate in a MEP, employers had to share some nexus or interest unrelated to the retirement plan, such as being in the same industry or geographic location, or members of an established trade association (the "commonality" requirement).
One Bad Apple Rule	The violation by one employer of any DOL or IRS code provision, such as a late deposit of salary deferrals, could make the entire plan noncompliant and create liability for an adopting employer (the "One Bad Apple" rule).[7]

Closed MEPs

Since traditional MEPs are only available to employers that share a commonality of interest based on the entity sponsoring the MEP, they are referred to as "closed MEPs." These have most commonly been sponsored by an employer association with members who share a common interest, such as a trade or industry association that offers the MEP to its members.

Closed MEP challenges

The commonality requirement limits the employers that can participate in Closed MEPs. Also, while the MEP Sponsor takes on significant responsibilities, the participating employers in the plan do retain some fiduciary responsibility, including:

- Performing due diligence regarding the capabilities and fees associated with a MEP prior to entering the MEP arrangement
- Monitoring the MEP Sponsor to ensure that it is prudently performing the duties delegated to it
- Timely depositing employee contributions and loan repayments consistent with DOL requirements

In addition to meeting these fiduciary responsibilities, a participating employer is typically responsible for certain plan design decisions such as the level of matching contributions, certain participant notices and communications, and enrollment assistance for its employees.

7. Government Accountability Office, *Private Sector Pensions: Federal Agencies Should Collect Data and Coordinate Oversight of Multiple Employer Plans*, GAO-12-665, Report to the Chairman, Committee on Health, Education, Labor, and Pensions, U.S. Senate, September 2012 (MEPs represented 0.7% of all plans filing a Form 5500 in 2009).

Secure act creates new avenue – the PEP

The SECURE Act, which became effective on December 31, 2019, makes a single plan for unrelated employers more accessible and attractive by removing the One Bad Apple disqualification rule and removing the commonality requirement. A new type of plan is now available - the Pooled Employer Plan. Closed MEPs may still be maintained, but the intent of Open MEPs was finally achieved through the creation of PEPs.

The new Pooled Employer Plan (PEP)

The SECURE Act modified ERISA and the Internal Revenue Code (IRC) to create PEPs, which effectively operate like an "Open MEP" for unaffiliated employers. Since there is no commonality requirement among the adopting employers, any employer can join, yet the PEP is still considered a single plan under ERISA and IRS rules.

The SECURE Act also simplified the One Bad Apple rule by requiring plans to have a process to remove a bad actor from the plan instead of disqualifying the entire plan:

- the assets of a noncompliant plan will be transferred to (i) a plan maintained solely by the noncompliant employer, (ii) an eligible retirement plan for each participant, or (iii) another appropriate arrangement (unless transfer is determined not to be in the best interest of plan participants); and
- the noncompliant employer will be liable for any liabilities of such plan attributable to the employees of such employer.

While a lead sponsor is no longer required, a PEP must provide for a process to disgorge a "bad apple" from the plan. In addition, the PEP must utilize a qualified Pooled Plan Provider (PPP) to run the plan. The PPP is an entirely new entity under ERISA and acts as the PEP's Named Fiduciary and Plan Administrator. PEPs can be instituted starting January 1, 2021.

PEPs can be instituted starting January 1, 2021

Any employer can join

Still considered a "single plan"

Lead sponsor no longer required

PEP must be offered by a Pooled Plan Provider (PPP)

PEP benefits

The benefits of participating in a PEP for an employer are much the same as for participating in a MEP, with the bonus that any employer, regardless of relationship to the other employers in the PEP, can join.

- Administrative outsourcing – expert administrator
- Fiduciary outsourcing – investment selection and monitoring
- Pooling among multiple employers – reduced administrative, trust and audit costs
- Pooling assets – greater bargaining power for investment fees and wider access to investment options
- One Form 5500 annual report (rather than a separate report for each employer)
- Bad actions by one employer do not destroy the entire plan

PEP challenges

Despite being able to offload much responsibility to the PPP, employers participating in a PEP are treated as the sponsor of the plan with respect to their employees, except for the duties assumed by the PPP. As such, each participating employer retains certain fiduciary responsibilities, including:

- **Selecting a PEP** – Employers must first determine that a PEP is the appropriate vehicle for employees' retirement savings, and then consider various factors to determine if a specific PEP is the right one, such as the fees of the PEP, the level of services and flexibility offered to participating employers, and whether they can leave the plan easily and have their portion of the plan spun off either to become an individual plan or be transferred to a more attractive MEP/PEP.
- **Selecting a PPP** – Each participating employer in a PEP will retain fiduciary responsibility for prudently selecting and monitoring the PPP and other designated fiduciaries of the PEP.
- **Selecting investments** – Employers have ERISA fiduciary responsibility for selecting, overseeing, and monitoring the investments of their portion of the plan's assets unless an ERISA 3(38) investment manager has been delegated this duty by the PPP or the employer.
- **Monitoring** – Each employer is responsible for prudently monitoring the ongoing performance of the PPP and other named PEP fiduciaries hired by the employer.
- **Nondiscrimination testing (completed by the PPP)** – Participant testing such as ADP and ACP testing is not applied across the PEP in aggregate, which means that each employer must be able to pass nondiscrimination testing based on its own plan participants and plan contributions.

Between hiring the PPP and other named fiduciaries, including selecting investment professionals, a PEP has multiple parts. As such, employers need to consider which PEP would be right for their business needs.

Becoming a Pooled Plan Provider (PPP)

A PPP may be an individual or entity, such as a TPA, insurance company, mutual fund manager, or financial professional. Like MEP Sponsors, the PPP is the named fiduciary of and has overall fiduciary responsibility for the PEP, including selecting and monitoring service providers. PPPs are the same as a 3(16) Plan Administrator and are responsible for performing all administrative duties (including conducting proper testing with respect to the plan and the employees of each employer in the plan). The PPP may designate other entities to share in the fiduciary oversight and investment responsibilities. Unlike a MEP Sponsor, however, a PPP may also provide services to the PEP such as recordkeeping or TPA services. Moreover, once established, a PPP can service more than one PEP.

Forming a PPP

An entity wishing to be a PPP must become qualified, which means that it must meet the following conditions:

- acknowledge in writing in the plan documents that it is a named fiduciary and the 3(16) plan administrator, and it must accept full responsibility for the plan meeting the terms of ERISA and the Internal Revenue Code.
- register with the IRS and the DOL as a PPP.
- participating employers must agree to provide to the PPP the information needed to properly operate the plan.
- make sure all parties handling plan assets are bonded, as required under ERISA and the IRC.

PPP registration requirements

On November 12, 2020, the DOL released its registration requirements for PPPs as required by the SECURE Act.[8] PPPs can start operating PEPs beginning on January 1, 2021, but they must register with the Labor and Treasury departments. While PPPs are required to register at least 30 days before beginning operations by electronically submitting the new EBSA Form PR (https://www.efast.dol.gov/), the DOL provided an exception for the period November 25, 2020 to January 31, 2021.

Possible PEP structures

There is no standard structure or operating model for PEPs, but they will likely operate under one of the following:

1. **Fully integrated model** – traditional 401(k) recordkeepers register as PPPs and start PEPs that integrate retirement plan administration, customer service, and investment management capabilities through one entity.

2. **100% service provider model** – an entity, such as a recordkeeper, trade association or financial professional, registers as a PPP and then engages one or more service providers to fill the roles necessary to offer a PEP.

3. **Hybrid model** – an entity registers as a PPP, performs some duties itself and engages additional service providers for the remaining functions.

Depending on the model, financial professionals may play a variety of roles with respect to PEPs. Depending on the structure of the PEP, a financial professional could act as a PPP or be hired by the PPP or a participating employer to act as an ERISA 3(38) investment manager for a PEP employer, or could provide ERISA fiduciary investment services to the PPP. PEPs provide unique business opportunities for financial professionals; however, a fully integrated model may seek to limit a financial professional's role by curtailing the investment options that may be used or cutting outside distribution altogether. This has the potential to evolve into an emerging and significant risk for such retirement plan professionals.

PEPs provide unique business opportunities for financial professionals.

8. Registration Requirements for Pooled Plan Providers, 29 C.F.R. Part 2510, DOL, EBSA (Nov. 12, 2020).

PEP costs and fees

The SECURE Act expanded the plan startup tax credit to provide that eligible employers may be able to receive up to $5,000 in tax credits, with an additional $500 tax credit available for using automatic enrollment in the plan, for the first three years the plan is effective.

There is no standard model or pricing structure for PEPs, and the one chosen will impact the costs of maintaining a PEP, which is why it is imperative that employers compare the pricing of available PEPs and PPPs. ERISA does not focus solely on fees - they are just a component of evaluating a plan and its service providers - so the cheapest option is not required, but employers must understand what they are getting. For example, each PEP adopting employer and its financial professional should understand if the PPP offers additional services to its employer clients or dictates the universe and/or share classes of investment options that may be used. It is critical to consider the pricing models used for PEP arrangements, including the extent of any cross-subsidization for different services or across different PPP clients.

Unanswered questions

There are details about plan structures and requirements that are not yet known. Until service providers fully understand their responsibilities and limitations under the rules, some may be reluctant to sign up as PPPs and fully implement new PEPs. There are many issues which are still awaiting regulatory guidance:

- The form and content of PEP plan documents, as well as an IRS model PEP plan document
- Specific guidance for PPPs on administrative responsibilities and those that can be outsourced
- Special Form 5500 rules for PEPs
- Whether PPPs may rely on existing prohibited transaction exemptions for conflicts from proprietary investments or receipt of revenue sharing to offset illustrated recordkeeping fees
- Disclosures about the PPP that must be made to employers
- Scope of unreasonable restrictions, fees, or penalties for employers wanting to leave a PEP or distribute assets from the plan
- How employers with a MEP can convert to a PEP
- How a PPP, as the primary fiduciary, can direct compensation to itself from plan assets

As a fiduciary, the PPP is subject to ERISA and the IRC, including the prohibited transaction provisions restricting fiduciaries of plans from engaging in transactions that involve conflicts of interest. Depending on how proprietary products are selected, the PEP may have to navigate ERISA's prohibited transaction rules in addition to evaluating performance and cost. The SECURE Act laid a solid foundation upon which to build PEPs, but there remains a great need for regulatory guidance. Conflicts could arise if the PPP incents or requires the use of proprietary investment products in the PEP.

Next steps

PEPs provide a unique vehicle through which employers can implement retirement plans and help employees better prepare for a secure future, while outsourcing much of the administrative and fiduciary responsibilities associated with sponsoring an ERISA plan. Although some questions remain, the SECURE Act has put a sound structure in place to begin moving forward on PEP establishment. At the very least, financial professionals and interested PPPs should identify potential employer candidates, both individuals and groups, that might be suited for PEP participation, and educate those candidates on the nuances of PEP participation.

Employer candidates and considerations

Candidates

- Employer with lack of financial or human resources or retirement expertise
- Don't have a plan
- Member of an association or a PEO
- Looking to improve administrative and/or investment costs
- Looking to outsource administrative responsibilities
- Want to shift fiduciary liability

Considerations

- Level of comfort with outsourced fiduciary responsibility
- Level of comfort delegating administration
- Level of comfort delegating investment selection – handle investments or outsource to PPP or 3(38) manager
- Desired plan design features – low cost and touch vs. high customization
- Determine if PEP is the right plan for employees
- Compare options and select PEP
- Compare options and select PPP

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