Pooled Employer Plans: Are PEPs Something to Cheer About?

In late 2019 when Congress broke its deadlock and passed the Setting Every Community Up for Retirement Enhancement (SECURE) Act, it was hailed as the first major retirement security legislation in more than a decade. The act was considered a win for the 38 million private-sector employees who currently have no access to a retirement plan, and whose retirement security may be precarious without one.

Among the SECURE Act provisions which we detailed earlier, one particular section governing pooled employer plans (PEPs) may herald changes to and growth in the 401(k) landscape, especially among smaller businesses. Jeanne Klinefelter Wilson, the Acting Assistant Secretary of Labor for the Employee Benefits Security Administration (EBSA) has said, "Pooled employer plans will give employers, especially small unrelated employers, a way of offering their employees a workplace retirement savings option with reduced burdens and costs."

Some providers in the retirement plan space have said that the expansion of PEP benefits, in fact, may impact 401(k) plan management beyond smaller employees. They foresee how professional organizations, trade associations, private equity firms and their portfolio companies may gain opportunities and efficiencies to both accelerate business growth and promote employee retirement readiness.

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>
> *Jeanne Klinefelter Wilson*
> *Acting Assistant Secretary of Labor*
> *Employee Benefits Security Administration (EBSA)*

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To appreciate why the SECURE Act and this particular PEP provision were legislative priorities for Congress, consider the state of retirement savings in the U.S., as summarized by the EBSA in its Notice of Proposed Rulemaking:

- **A Significant Savings Shortfall:** 22% of Americans have less than $5,000 saved for retirement, and 15% have no retirement savings whatsoever. (2019 Planning & Progress Study)
- **An Underfunded Social Security System:** The trust fund for the retirement benefits program is projected to run short in 2035, at which time tax revenue will only cover 76% of retirement benefits. That's only 15 years from now. To date, no political party nor its representatives have championed reform policies that would require a cut in benefits, an increase in payroll taxes, or likely both. No one gets elected on those promises. (2020 Annual Report of Social Security)
- **Access to Retirement Plans:** While an employer-sponsored 401(k) plan is considered the most powerful tool for building retirement savings, right now, only five in 10 workers at private-sector, smaller businesses (of fewer than 100 workers) have access to a retirement plan. (U.S. Bureau of Labor Statistics)
- **Barriers to Establishing a Plan for Employers with 5-250 Employees:** Small- to mid-size employers who don't offer a plan point to the financial cost (37%) and organizational resources (22%) needed to start a plan as barriers. (Pew Charitable Trusts)
- **Fiduciary and Administrative Requirements of Retirement Plans:** Governance, compliance, and administrative issues can be a drain on company resources, or worse, they can pose litigation risks.

The SECURE Act of 2019 was intended to minimize these cited obstacles, to reduce some administrative and fiduciary obligations, and enhance the ability of employers of all sizes to offer and manage retirement programs for their employees. Up to this point, employers have had two options for offering a retirement plan:

- *A single employer-sponsored 401(k) plan or a single employer-sponsored 403(b) plan in the nonprofit sector,* in which participation is limited to the employer/sponsor and members of its group.
  - The plan administrator is responsible for ensuring the plan satisfies all ERISA requirements, including filing an annual report (Form 5500) with the Department of Labor (DOL), as well as the requirements of the Internal Revenue Code (Code).

- *A multiple employer 401(k) or 403(b) plan,* in which two or more unrelated employers participate as long as these unrelated employers share a common nexus (such as industry or geography).
    - In these cases, the arrangement is recognized as a single plan (often referred to as a "closed MEP") for purposes of satisfying many of ERISA's requirements, such as the annual Form 5500 filing.
    - By contrast, if a plan included unrelated participating employers that did not share a common interest (referred to as an "open MEP"), the DOL considered each participating employer as maintaining its own plan with requirements to file a separate Form 5500 and obtain an independent audit, if applicable. (Effectively eliminating the benefit of a joining with other employers to offer a plan in the first place.) DOL regulations also generally precluded banks, insurance companies and other financial services firms from acting as sponsors of MEPs that were intended to be treated as a single plan.

Because of legal impediments to maintaining open MEPs, small and mid-sized employers have been left to grapple with cost, legal exposure, and the administrative responsibilities associated with a single employer 401(k) plan. Or, as the data suggests, to forgo offering a plan at all, as 50% of smaller businesses have.

And, those hurdles related to open MEPs in the for-profit arena exist in the non-profit sector as well. While colleges and universities have successfully organized in closed MEPS around a common nexus, other nonprofits including cultural, charitable, and human service groups like food banks, performing arts companies, and

Nonprofits May Be Next:

For now, PEPs are limited to 401(k) plans. Defined benefit plans, 403(b) plans, governmental 457(b) plans and multi-employer plans for collectively bargained employees are excluded from the new PEP provisions.

However, in late October 2020, the House Ways and Means Committee released proposed retirement reform legislation called the Securing a Strong Retirement Act of 2020. If passed, Section 109 of the act expands retirement savings options for nonprofit employees by allowing 403(b) plans to benefit from the same provisions now approved for pooled employer plans. (See a summary here.)

Eric Levy, speaking on behalf of AIG Retirement Services, a major 403(b) recordkeeper has said, "Many of these types of organizations are small and do not have the resources to provide retirement plans to their staffs, who do very important work in our communities. The ability for these organizations to join an Open MEP designed for like organizations will help drive further expansion of retirement savings to more Americans."

homeless shelters, cannot organize around a common nexus, and may be too small in size to offer a retirement plan to their employees.

The SECURE Act allows for a new pooled employer retirement vehicle, the PEP, in which unrelated employers may participate, in what can be thought of as an Open MEP. These 401(k) PEPs will be sponsored by a "Pooled Plan Provider" (P3), which will be responsible for most fiduciary and administrative duties related to the PEP. This reduces some employer responsibility and limits employer legal exposure for such matters as well. By virtue of group purchasing power, PEPs also offer the possibility of lower costs than single employer plans and access to a broader menu of investment options.

The SECURE Act opened the door to PEPs with the potential for these benefits to participating employers:

- ☑ Establishment of a Pooled Plan Provider to serve as plan sponsor. *Which means employers (or associations, trade groups, or private equity firms, for example) will not be a named fiduciary.*
- ☑ Mitigation of employer fiduciary liability by designating many responsibilities to PEP administrators. *Which limits employer compliance risk.*
- ☑ Elimination of individual plan audits and Form 5500 filings. *Which alleviates some administrative responsibilities and cost for participating employers.*
- ☑ Dissolution of the "one bad apple" rule that could disqualify a plan based on the violation of a single adopting plan member. *Which gives employers greater confidence in the long-term viability of the plan.*
- ☑ Opportunity for unique retirement plan design specific to each employer. *Which allows participating employers to offer a plan tailored to their organization, and presented as such.*
- ☑ Consideration of shared service so that any participant vesting or eligibility with one PEP employer transfers if they leave and join another employer in the same plan. *Which makes the plan and the employers within it attractive for talent recruiting purposes.*
- ☑ Expands access to a larger universe of investment options and the potential for cost savings. *Which helps participating employers provide a quality retirement plan that enhances employee financial welfare.*

Assembling the Team

The PEP Organizes around its Pooled Plan Provider

The PEP's **Pooled Plan Provider (P3)**, serves as the plan's administrative fiduciary and, effectively, its quarterback. According to the SECURE Act, the P3 need not be affiliated with the PEP's participating employers. This means retirement service firms of all types (including insurance companies, banks, trust companies, consulting firms, recordkeepers, third-party administrators and associations, among others) can organize PEPs. That said, the DOL, among others, believes the role will likely be filled by firms already serving as 3(16) administrators for single or multiple employer plans. In fact, the DOL has estimated a universe of more than 38,000 entities that could register as a P3, but it expects that number to winnow to 3,200 entities that will actually enter the market.

With an ERISA 3(16) administrator's discretionary authority and control over plan management, the P3 has duties including:

- ☑ Drafting the plan document
- ☑ Delegating responsibilities to other plan fiduciaries
- ☑ Hiring or replacing plan service providers
- ☑ Negotiating fees with plan service providers
- ☑ Making amendments to the plan
- ☑ Signing and submitting the Form 5500 (including a list of all participating employers) and other required government filings
- ☑ Responding to any DOL audits or investigations

It bears repeating, the P3 is quarterback and linchpin. *The responsibilities of the named fiduciary, the administrative fiduciary, the trustee, and the investment manager all transfer from the employer to the P3 and its other selected fiduciaries.* (But note, the participating employers are still obligated to monitor the P3 and how it executes its duties.)

With such significant fiduciary and administrative duties to fulfill, it's little wonder that emerging PEP models suggest two alternative structures that don't rely exclusively on the P3, but instead, involve a team of service providers, each with a specific role to play. Broadly, the three types of PEPs include:

1. ***Fully bundled solutions:*** The P3 employs its affiliates as providers, with the possible recommendation of the P3's proprietary investment products.

2. ***Partially bundled solutions:*** The P3 selects service providers who, themselves, could offer a slate of their proprietary investment products.

3. ***Completely unbundled and unconflicted solutions:*** The P3 is a third-party administrator with no service provider affiliates and no proprietary investments.

Fully bundled (and conflicted) solutions have been the object of study by the DOL. On June 18, 2020, the department issued a request for information (RFI) to help shape its guidance on business models and anticipated conflicts of interest. As of the July 20 deadline, the DOL had received 30 responses from interested parties including law firms, investment advisors, insurance companies, and professional associations.

The issues of conflicts and self-dealing were the subject of the letter from the American Retirement Association. In part, the letter reads, "The question is whether a PPP's decision to offer its services for fees it sets itself, or to select itself to provide additional services to the PEP for additional fees, would constitute fiduciary self-dealing in violation of ERISA Section 406(b)(1) for which no exemptive relief is currently available."

In his response to the DOL request, House Ways and Means Committee Chairman Richard E. Neal (D-MA) wrote, in part:

> *The Department should not consider promoting and permitting conflicts of interest. My understanding is that many retirement plan service providers have for many years run multiple employer plans without conflicts of interest. Moreover, I further understand that these conflict-free arrangements are actively being adapted to form conflict-free PEPs, which become effective in 2021.*
>
> *With flourishing conflict-free business models in existence and being developed, the Department should reconsider permitting conflicts of interest that can undermine the interests of both plan participants and small businesses. I ask that you not allow harmful and unnecessary conflicts of interest to undermine PEPs, a centerpiece of this landmark legislation. Hard-working Americans and the small businesses of this country deserve better.*

As of this writing the DOL has not published its guidance on self-dealing and prohibited transactions. Until such time, an unbundled PEP structure would appear to be the least objectionable, and the most likely model to implement without risk of self-dealing and any related (and litigated) issues of excessive fees that have plagued plan sponsors in the nonprofit sector in recent years.

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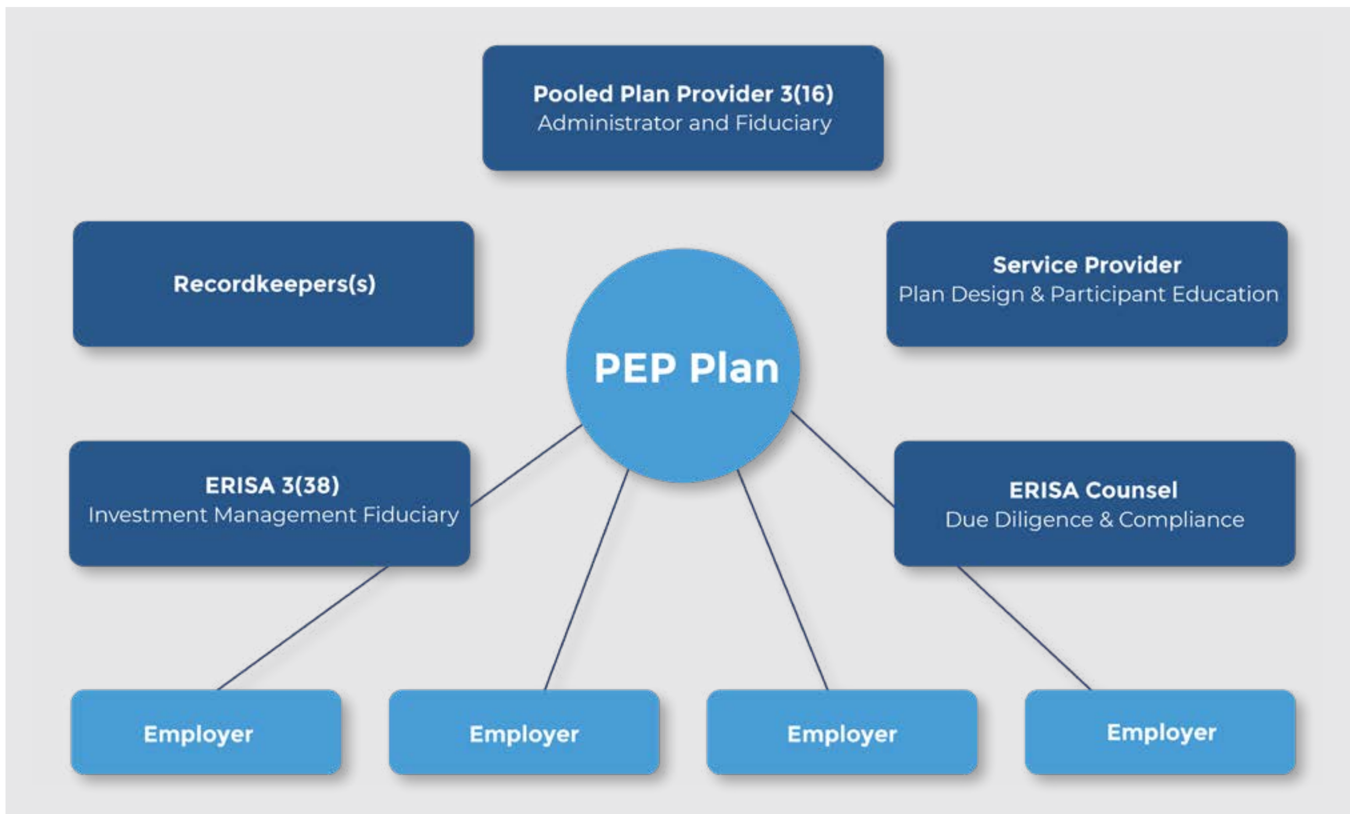
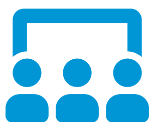
The Rest of the PEP Team

If an unbundled, unconflicted plan becomes the PEP plan of choice, its structure could look very much like the one shown below.



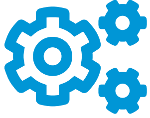
The players and their respective duties in the unbundled model include the following:



Participating Employers

Participating employers retain two essential responsibilities:

- Selecting and monitoring the P3 and any other named fiduciaries of the plan. (Note: plan administration is not an employer duty because the P3 is the named 3(16) administrative fiduciary.)
- Choosing and monitoring the investments offered in the plan, unless the P3 delegates that responsibility to a 3(38) investment manager.



Pooled Plan Provider (the P3) and Plan Administrator 3(16)

- A named fiduciary of the PEP, acknowledged as such in writing.
- Responsible as the PEP's administrator according to ERISA 3(16), though some of these administrative functions may be delegated.
- Registered with the DOL and the Internal Revenue Service (IRS).

The P3 must obtain an ERISA bond for the plan as well as register with Department of Labor. PEP assets must be held by a bank or trust company as the trustee, with responsibility for safeguarding the assets and for collecting deferrals and contributions.

Service Provider – Plan Design and Participant Education

- Manages participating employer development and onboarding.
- Provides participant enrollment and related educational services.
- Provides ongoing oversight including plan design reviews and changes, plan administrative questions and concerns, and quarterly planning committee agenda preparation.

Recordkeeper

- Tracks all the accounts and the money flowing into and out of them, including investment purchases and sales.
- Tracks eligibility of participants across employers (e.g., when an employee leaves one employer for another inside of a PEP, their eligibility goes with them).

The PEP plan may or may not require a change of recordkeeper for the participating employers. (A continuation of service would make the transition easier and avoid a black-out period.) And while PEPs may require more complex logistics than those required by stand-alone plans, industry experts think PEPs will promote positive changes that will streamline recordkeeping processes.

Investment Advisor

- A named 3(38) fiduciary of the PEP, acknowledged as such in writing.
- Responsible for the investment lineup available to the PEP members.
- NOTE: the SECURE Act says that If a 3(38) investment manager is not retained to select investments, the employer/plan sponsor will be responsible for investments.

ERISA Counsel

- Law firms are permitted to serve as a P3, and their expertise with ERISA, the IRS, and DOL may confer a distinct advantage to the PEP.
- ERISA counsel to PEPs will be helpful in the creation of plan structure and documents. However, until guidance is issued from the IRS and DOL, those acting as P3s will not be treated as failing to meet requirements if they comply in good faith with a reasonable interpretation of the law.

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Gametime – the Timeline for PEPs

The rules governing the creation and organization of PEPs were emerging even as PEPs formed. On November 20, 2020 the DOL issued its final rule regarding registration.

This rule establishes an electronic registration process for businesses seeking to offer pooled employer plans. The process requires pooled plan providers to register at least 30 days before beginning operations.

Under the DOL proposal published in September 2020, and confirmed in the final rule, the registration process involves:

- an initial registration
- supplemental filings regarding specific reportable events
- a final filing after the provider's last pooled employer plan has been terminated and ceased operations.

Pooled plan providers must register by electronically submitting the new EBSA Form PR. The new electronic filing system was available on Nov. 25, 2020 at https://www.efast.dol.gov/.

The Timeline for PEP Formation

- **December 2019 -** SECURE Act permitting Pooled Employer Plans is passed and is signed into law.
- **June 2020 –** The Employee Benefits Security Administration of the DOL issues a Request for Information on the topic of prohibited transactions.
- **July 2020 –** DOL receives 30 replies to requests for comments.
- **August 2020 –** The DOL announces a proposed rule on how to register as a pooled plan provider and it issues a related fact sheet. This "Notice of Proposed Rulemaking" (NPRM) includes a mock-up of a new Form PR, and instructions.
- **September 2020 –** The DOL proposal is published in The Federal Register and DOL requests comments accepted through October 1, 2020.
- **November 2020 -** The DOL issues its final rule on registration requirements. Initial registration is to be filed by P3 no sooner than 90 days before and no later than 30 days before it begins operating (defined as marketing or publicly offering a PEP) as a pooled plan provider.
- **January 2021 -** PEPs become available for plan years beginning on January 1, 2021.

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The Scouting Report on PEPs – Is it Hype or Something More?

Whether pooled employer plans will revolutionize the way American workers save for retirement is yet to be seen, but PEPs are certain to be a topic of interest in 2021 and beyond. It's worth understanding the potential of PEPs, and also the hype surrounding offers that sound too good to be true. A closer look at PEP promises may help plan sponsors assemble the right team to achieve retirement readiness for their employees. Here's a look at touted benefits and considerations for sorting the hype from the score.

- **Fiduciary Responsibility.** In addition to having the P3 serve as a named fiduciary, many PEPs, namely unbundled and partly bundled models, will likely appoint an investment manager to a 3(38) fiduciary role. This frees participating employers from most of the fiduciary responsibilities they must fulfill if the investment management role isn't delegated in the PEP.

  The Hype: *That sounds ideal and nearly foolproof, but the claim that "delegating legal and compliance responsibilities to a plan fiduciary protects PEP members from all fiduciary risk" is one no reputable fiduciary will make. There is no "plug-and-play" option for sponsors of any retirement plan.*

  The Score: *A pooled employer plan can alleviate the burden of regulatory compliance, but it can never eliminate it altogether. Failure to recognize that comes at a cost. A team of fiduciaries can advise the P3 in matters of compliance, plan design, and investment options, but it's up to PEP partner-employers to "monitor" the P3 and any named 3(38) fiduciary, ensuring that they are doing a competent job for reasonable fees. This concern grows greater as PEPs raise other potential conflict of interest concerns, including whether the P3 can serve in the dual role as the 3(38) investment manager and whether proprietary products can be included in investment lineups.*

  The fiduciary duties of the P3 include things like convening investment management meetings, recording minutes, performing fee benchmarking and RFPs and RFIs and investment policy development and refinement--all activities to demonstrate that PEP participation is, in fact, prudent. This is, of course, the standard that fiduciaries (including PEP sponsors) are charged to uphold.

- **Administrative Obligations.** Our current regulatory environment demands administrative expertise that's beyond the capacity of many employers. In fact, delegating these day-to-day operational and compliance duties to the P3 with ERISA 3(16) fiduciary authority transfers much of the legal responsibility for a retirement plan from the participating employers to their P3 designated fiduciary.

  The Hype: *Outsourced administrative services can save employer members the time and energy that too often distracts from more critical responsibilities. PEPs make that increasingly attractive option more available and affordable. BUT… Delegating administrative duties isn't the same as relinquishing them. The buck still stops with the employer.*

  The Score: *A competent pooled plan provider transacting its 3(16) fiduciary duty can help insulate PEP members from errors that can trigger significant penalties both for the fiduciary and the PEP members themselves. The PEP employer members are still responsible for the prudent monitoring of the PEP's P3 and service providers. This involves regular and systematic monitoring of their performance and collaboration on behalf of the PEP.*

- **Fees.** The participation of many employers in a PEP can allow for a larger asset base and recent research shows that plans with larger asset bases do benefit from lower fees. An August 2020 report from Brightscope revealed how bigger plans are associated with smaller fees:

  - **1.42%:** Total plan cost for average 401(k) participant in plan with less than $1 million in assets, 2017. (Includes investment, administrative, and other fees.)
  - **0.26%:** Total plan cost for average 401(k) participant in plan with more than $1 billion in assets, 2017. (Includes investment, administrative, and other fees.)

  A PEP may allow participating employers to achieve the buying power discounts of larger organizations.

  The Hype: *Management fee savings are possible, but some costs are less obvious than others. In addition to asking about hard dollar management and per-participant fees, employers should ask about any soft dollar fees, or the cost of commission-based product sales at the participant level that erode investment gains and retirement savings balances. Is the P3 selling proprietary funds or insurance products?*

The Score: *PEPs can confer more than just investment management fee savings. The plan's P3 should demonstrate how they can and will conduct fee audits and benchmarking of all related service providers like the PEP's custodian, recordkeeper, and any other named fiduciary, like the 3(38) investment advisor.*

Potential savings could include reductions in fixed administrative costs, investment pricing and administrative time for participating employers. Also, any fees paid to an advisor or consultant for monitoring plan investments can be shared by multiple employers, potentially reducing the cost to each. And, finally, recognize that cost savings will be realized with scale. It may take time for certain PEPs to reach an asset size that can deliver cost savings to adopting employers.

- **Investment Fund Selection.** Improved PEP buying power may open doors to investment options that previously had been available only to larger institutions.

  The Hype: *While PEPs may promise more expansive fund lineups, most participants in retirement plans don't need more investment options, they need institutional quality, lower-cost options. On the other hand, providers with a limited menu of investment options may offer proprietary or retail investment products. Here again, the PEP's adopting employers must understand the fund lineup and who the most likely beneficiaries are: their employees or the advisor?*

  The Score: *What can matter as much as the investment lineup is whether or not the P3 has developed a plan design that takes into account the demographics, preferences, and savings behaviors of plan participants.*

  A retirement plan offered through a PEP should offer more than investment product buying clout. It should help adopting employers arrive at a plan that is above reproach from a fiduciary standpoint and one that has the structure and features to provide the best possible outcomes and the lowest possible costs for all plan participants. (This may include auto enrollment and escalation features, employer contribution structures, and ROTH options.) To get the score on the PEP's investment line-up, plan sponsors should ask about the management expenses of the investment products within it, the rigor of plan design, and the guardrails of a meaningful investment policy statement.

- **Participant Education.** PEP employers that were unable to offer thorough participant education before affiliating can benefit from a pooled plan provider or advisor customizing an education program for its members. Unbundled PEPs may even engage a third party for comprehensive education programs and one-on-one advice.

    The Hype: *A P3 may promise a comprehensive education program, but ask for details: Will it include presentations and/or one-on-one advice? How will multiple employer sites be served? Can employers protect their employees from conflicted or commission-based advice? Does the recordkeeper offer tools and services to help minimize education expenses and provide personalized guidance? How do employers monitor performance, adjust fees or dismiss the provider if the program isn't delivered to your satisfaction?*

    The Score: *Like effective plan design, an impactful education program will account for participant demographics, personal finance expertise, and savings behavior. Messaging strategies based on these factors should move the retirement readiness needle. PEPs are well positioned for sharing and implementing best practices in this and similar matters. As an example, technology can be leveraged to target information according to participant demographics and life-event triggers (like marriage, births, etc.) If participating employers can monitor the program and have access to mechanisms for evaluating, and improving it, the PEP should improve the financial literacy and retirement readiness of participants.*

Pooled Employer Plans: Celebrate What's Truly a Victory for Employers and American Workers

As mentioned in the opening of this discussion, nonprofit organizations have participated in multiple employer plans (closed MEPs offering 403(b)s to their employees) for years, and not without issue. In recent years, a spate of class-action lawsuits have been filed against colleges and universities over excessive fees and confusing and superfluous investment options in these 403(b) plans. The DOL has gone on record with a warning about these multiple employer plans that could be issued to PEPs as well. The warning is this: "The potential for inadequate employer oversight of the MEP is greater because employers have passed along so much responsibility to the entity controlling the MEP. Labor officials noted that potential abuses might include layering of fees, misuse of the assets, or falsification of benefit statements."

That's a fair warning, and not a reason to dismiss the considerable benefits of a PEP. Rather, it's a good reason to enlist the help of independent, objective advisors who can guide your evaluation. The potential benefits of a PEP are contingent on a myriad of factors outside the control of the employer/plan sponsor considering them:

- Will the asset pool be large enough to effect meaningful cost reductions?
- Is the Planned Pool Provider experienced enough to direct a PEP and effectively reduce day-to-day administrative demands and to assign or assume the fiduciary obligations of the P3, the 3(16) administrator and, if appointed, the 3(38) investment advisor?
- Does the PEP's fiduciary process adequately support the adopting employers and protect them from litigation for any breach of fiduciary duty?
- Are the fund options, the plan features, and the participant education experience robust enough to actually enhance the retirement readiness of workers the plan is created to help?

These evaluations may be difficult, if not impossible, to make in the short term. Meanwhile, Highland will continue to monitor legislation, opportunities, and PEP formation to determine if PEPs are to become a true and lasting win for participating employers and American workers who need a lift to achieve their retirement goals.

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