Pentegra's Stance On Open MEPs

A WHITE PAPER BY

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PENTEGRA

One of the nation's largest MEP providers weighs in on the debate over "open" multiple employer retirement plans

Open multiple employer plans ("MEPs") are here to stay for all the right reasons—economies of scale, a favorable effect on societal retirement coverage, outsourcing of responsibility to professional fiduciaries, and an elevated level of governance and attention to detail that employers of all sizes are unlikely to achieve without costly assistance. The compliance considerations for open MEPs are different from the considerations for other MEPs and for multiple employer trusts ("METs"), and Pentegra remains mindful of those differences as it has for nearly 70 years of building and serving multiple employer arrangements of all types.

Multiple Employer Plans (MEPs) bring expert fiduciary governance and economies of scale to retirement plans of all sizes and types. In the past few years, intensifying in mid-2011, the pension community's attention has been drawn to a type of plan that has grown rapidly in popularity: "open" MEPs—those open to any participating employer[1].

This brief explores a much-publicized compliance risk—the concern that the Department of Labor (the "DOL") would not consider open MEPs to be single plans under the Employee Retirement Income Security Act of 1974, as amended (ERISA). Pentegra's response to this issue can be summarized as follows: open MEPs are, and have always been, among the safest and most beneficial retirement plan structures when properly governed. Proper governance includes ensuring that the plan meets the provisions of ERISA, and in particular the Annual Report (i.e., Form 5500) and audit requirements. Pentegra takes a conservative legal stance on open MEPs and will file separate Form 5500s for each of an open MEP's participating employers and require a separate plan audit for each large employer unless and until the MEP's status as a single plan under ERISA is unlikely to be challenged. The additional reporting and audit requirements do not impair a MEP's status as a multiple employer plan under the Internal Revenue Code (the "Code"), nor its ability to provide substantial fiduciary outsourcing and cost benefits.

[1] The term "open MEP" is a term of art, not law, and thus has no formal definition.

Clearly, however, unnecessary added costs harm participants, and as part of its duty as a MEP fiduciary Pentegra will continue its decades-long efforts with regulators and legislators to structure responsible solutions in cases where the law is incomplete or unclear, or when beneficial change is indicated—as it is with respect to several issues concerning MEPs, not just the Form 5500 and plan audit issues that arise in open MEPs.

MEPs and other fiduciary outsourcing solutions are poised for sustained growth as part of the rapidly intensifying movement toward relieving employers of fiduciary burdens while controlling costs. Whether a MEP is a single or multiple employer plan for ERISA purposes will have little impact on this movement.

Background

A group of multiple employer plan experts and operators, including the general counsel for Pentegra Retirement Services, Robert Alin, members of the Groom Law Group, and others, met last year with DOL officials to discuss open MEPs. Subsequent to that meeting, ASPPA[2] published an "ASAP"—a brief for its members—in which attorney Derrin Watson pointed out that the DOL may not consider open MEPs to be single plans for ERISA purposes. A more formal analysis by Watson[3] appeared in the Winter 2012 issue of the *Journal of Pension Benefits* and took a stronger stance, expressing the view that open MEPs do not appear to be single plans in the DOL's eyes based on a thorough review of existing DOL guidance. Other experts and operators in the MEP industry have offered a wide variety of comments on the subject, leading to some confusion about the status of open MEPs.

The question of a MEP's single plan status under ERISA is not new, but the recent attention has been substantial.

DOL Makes Its Views Known: Advisory Opinion 2012-04a

On May 25, 2012, the DOL published an Advisory Opinion taking the position that the 401(k) Advantage LLC ("Advantage") open MEP is not a single plan for ERISA purposes. The DOL's reasoning is consistent with its approach in certain previous guidance and can be summarized as follows:

- A single multiple employer plan may exist "…where a cognizable group or association of employers…establishes a benefit program for the employees of member employers and exercises control of the amendment process, plan termination, and other similar functions on behalf of these members with respect to a trust established under the program."
- Relevant factors to consider when determining whether an entity is a "bona fide group or association of employers" include how members are solicited; who may participate; the purpose of the organization; what, if any, were the preexisting relationships of its members; and the participating employers' control over the program, both in form and substance.
- There is no "…employment based common nexus or other genuine organizational relationship that is unrelated to the provision of benefits…" in the Advantage plan.
- The notion that this position on open MEPs (i.e. that they are not single ERISA plans) comes from MEWA guidance and should not be applied to pensions is dismissed by the DOL: "…the term 'employer' should have the same meaning in this context whether applied to the term welfare plan or pension plan."
- Advantage is not a "bona fide group or association of employers" based on these criteria and therefore does not meet the definition of "employer" under ERISA §3(5). Consequently the Advantage MEP is not a single plan under ERISA.

[2] The American Society of Pension Professionals and Actuaries

[3] "Multiple Employer Plans: An ERISA Enigma," S. Derrin Watson, Journal of Pension Benefits, Volume 19, No. 2

An advisory opinion is applicable only to the person to whom it is addressed but provides excellent insight into the DOL's thinking on a subject. Here are several points worth noting about the Advisory

Opinion:

1. **Open MEPs are Not Single ERISA Plans**. As expected, the Advisory Opinion supports the view that the DOL views open MEPs as a collection of single plans sponsored by each participating employer.
2. **Criteria for Evaluating who is Eligible to be an "Employer."** There is a list of criteria that a group or association of employers may use to help evaluate whether it is "bona fide" for purposes of determining whether the DOL would consider it to be an "employer" and therefore able to sponsor a single pension plan under ERISA. "Bona fide" groups or associations may be "employers" for ERISA purposes.
3. **The MEP is Still a MEP.** The Advisory Opinion does not express "any opinion in this Letter on the application of section 413(c) of the Internal Revenue Code…" MEP status under the Code is well-established for open MEPs, as discussed below, and is in no way being challenged.

Another Strong Indicator Of DOL's Mood: *Solis V. Hutcheson*

On May 15, 2012, Secretary of Labor Hilda Solis filed a memorandum in support of a restraining order in the case of a MEP fiduciary accused of diverting over $3 million in plan assets for his own use. In the memorandum, the Secretary takes the position that the MEP ("RSPT") was not a single plan for ERISA purposes:

> *In fact, RSPT was not a single "multiple employer plan" pursuant to ERISA. This is because there was no commonality of employment-based interest among the participating employer sponsors of the plans apart from the provision of retirement benefits, and there was no control of the program by the participating employers such that RSPT qualified as a "group" or "association" of employers as required to be a single plan covering multiple employers for purposes of ERISA § 3(5), 29 U.S.C. § 1002(5). Thus, RSPT failed to qualify as a single "pension plan" for purposes of ERISA § 3(2), 29 U.S.C. § 1002(2), since it was not established or maintained by an "employer" for purposes of that section…Instead, each of the employers that signed up with RSPT individually established a separate plan subject to Title I of ERISA for the purpose of providing pension benefits to its own employees.*

Again the DOL adopts the legal position that there is no "group or association" of employers in an open MEP, as required to meet the definition of an "employer" under ERISA §3(5).

What The Fuss Is About: The Audit And Form 5500

What is the practical impact if an open MEP is not a single plan for ERISA purposes as the DOL's guidance suggests? On the surface all of ERISA's many requirements would then apply at the individual employer level and this might seem a cause for concern, but **as a practical matter this does not have any impact on the ability of the participating employers to comply with the requirements under ERISA because ERISA compliance is outsourced to the MEP's fiduciaries**. Participating employers in most MEPs have only a single, very manageable fiduciary duty: the obligation to select and monitor the MEP arrangement and its fiduciaries. In a typical MEP the named fiduciary, trustee, and administrator roles are outsourced to a professional fiduciary, and the efficacy of the outsourcing is unaffected by whether

the plan is a single or multiple employer plan for ERISA purposes, even though not all arrangements will be identically governed.

The open MEP discussion can therefore be reduced to a simple question of compliance: how must ERISA's Annual Report requirement be applied? The bottom line is cost vs. participant protection. A MEP that is treated as a single plan for ERISA purposes meets the Annual Report requirement[4] (Form 5500, including an independent audit for plans with 100 or more eligible participants) by filing a single Form 5500 and performing a single, plan-wide audit. A MEP that is treated as a separate plan for each employer under ERISA must file separate Form 5500s and meet the audit requirement individually, even if the MEP is still considered a MEP for tax purposes under the Code. More paperwork means more cost, but the Annual Report requirement was created as a protection for participants, thus the debate. Since the DOL is charged with protecting participants, it is not surprising that it does not agree that a MEP is a single plan in every circumstance.

There is another critical factor involved beyond the annual cost of compliance: the potentially large cost of correction for MEPs that have incorrectly filed a single Form 5500 in the past.

The Fear For Existing Open MEPs: Retroactive Corrections And Penalties

Open MEPs that have historically filed the Form 5500 and applied the audit requirement as a single plan could be liable for penalties and fees associated with failure to file if it were found that ERISA requires separate reporting and audits for each employer. The cost could be significant: (1) $25/day, to a maximum of $15,000, from the IRS, and (2) up to $1,100/day from the DOL from the date of the failure to file for each participating employer for each year[5]. Such arrangements might find themselves subject to participant and employer lawsuits in addition to DOL penalties. The possibility that existing open MEPs might have to file late Form 5500s and pay the associated costs therefore represents a major risk for those plans and a business risk for entities sponsoring, serving, or participating in them.

Many commentators believed that if the DOL were to rule that open MEPs must meet the Annual Report requirement at the employer level, transitional relief would be granted such that no retroactive corrections and penalties would apply. However, there was no assurance that this would be the case. Such relief was conspicuously absent from Advisory Opinion 2012-04A.

What Is Not At Issue: Status Of The MEP Under The Internal Revenue Code

The Form 5500/audit requirement is the only concern raised by the classification of an open MEP as single plans under ERISA. The status of an open MEP as a multiple employer plan under Code §413(c) is not at issue. The tax qualification of the MEP is not at issue. The compliance of the MEP with other ERISA and Code requirements is not at issue[6]. How the MEP files its annual paperwork is the issue—one Form 5500 and audit or many—and how simple and less costly that process might be if the MEP were treated as a single plan by the DOL.

All of ERISA Title I applies to an open MEP at the individual employer level, according to the DOL's interpretation of the statute, but in practice an open MEP has no trouble satisfying ERISA's requirements collectively for the MEP other than the Annual Report/audit requirements.

[4] ERISA §101(b

[5] ERISA §502(c)(2)

[6] Some commentators have noted that the bonding requirement is a concern, which is technically true, but as a practical matter it is a non-issue because a single bond can cover all "plan" fiduciaries in a MEP, regardless of how the DOL views the status as a single plan under ERISA.

Cost And Protection Viewed Two Ways

Interestingly, applying the audit requirement at the employer level might actually decrease costs in some cases since most employers are small employers (over 80% of Form 5500 filers have fewer than 100 eligible participants). Most open MEPs have a plan level audit, for which all participants typically bear a cost; applying the cost at the employer level might therefore cause some participants' fees to decrease. In general, however, Pentegra's experience has been that a single Form 5500 and audit is the most efficient and least costly approach, even for small plan filers.

Another point of interest is that when a MEP files a single Form 5500 it will have an audit for the entire arrangement. Small plan filers, by contrast, will not have an audit if the requirement is applied separately. Thus, participants employed by employers with fewer than 100 eligible participants gain audit protection in a MEP that files a single Form 5500, but have no such protection if the audit requirement is applied at the employer level. As a result, filing a single Form 5500 arguably provides greater protection for the employees of most employers, since most employers are small plan filers.

The Policy Argument: Pro And Con

Multiple employer arrangements (MEPs are not the only type of pooled arrangement involving multiple employers) offer the potential for economies of scale and efficient, professional fiduciary oversight that might otherwise be unavailable to a small or mid-sized employer. They can therefore be a tremendous source of benefits for American workers, and supporting their formation and operation is sound public policy.

But not all MEP custody and safekeeping arrangements are the same. At a time when some arrangements have come under legal and media scrutiny due to charges of wrongdoing[7], it is clear that the annual report and audit serve an important function. In arrangements that lack the controls, checks, and balances of an institutional fiduciary[8]—rather than an individual or otherwise non-regulated fiduciary—it is not surprising that the DOL wishes to err on the side of caution when multiple, inexpert employers rely on the same fiduciary.

Pentegra's Long-Standing Legal Interpretation Of MEP Status Under ERISA

It has been Pentegra's long-standing position that there is no statutory basis for deeming an open MEP to consist of separate ERISA plans required to file individual Form 5500s and conduct separate plan audits, while at the same time acknowledging that there is also no statutory basis for taking the opposite position. The law is silent on the matter—ERISA does not contain a specific definition of "multiple employer pension plan.[9] Consequently, the DOL has crafted a position that it considers to be protective of participant rights, as is appropriate. But it is within the DOL's purview to adjust its stance in ways that protect participants but also **reduce cost and administrative burdens**, **improve coverage**, and **improve fiduciary governance**—all of which an open MEP is ideally suited to accomplish.

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[7] Solis v. Hutcheson

[8] "Institutional fiduciary" is used here to refer generally to a regulated financial institution accustomed to serving as a professional retirement plan fiduciary.

[9] For example, what is a "group or association" of employers? The statute is silent, necessitating the DOL to define "group or association, leading to its use of the term "bona fide" and the application of a number of non-statutory rules in its advisory opinions. Definitions of "group or association" other than the one provided in some DOL guidance are certainly plausible.

Because Pentegra believes that requiring individual Form 5500s and separate audits in a well-run MEP results in additional costs without any corresponding benefit for participants, we will continue to work with the DOL and Congress to seek solutions. The protections gained through the correct application of the Annual Report requirement are substantial, but *those protections are unrelated to whether a plan is a single or multiple employer arrangement*. In the *Hutcheson* case, for example, the alleged problem is not related to the number of audits and Form 5500s but to the unparalleled access to funds available to a person who is not a regulated financial institution—a problem that can and does occur in single employer plans (with far greater frequency, in fact). Pentegra therefore believes that the best protection for participants is better governance, not additional reporting.

Examples Of Governance Structures That Protect Participants

The following are all methods whereby participant protection may be enhanced in a well-run MEP.

- Member boards of directors with control over fiduciary and service provider appointments
- The use of regulated financial institutions as MEP fiduciaries
- Clear and well-implemented proxy and redress procedures for participating employers
- A prudent annual review process by and for participating employers

Open MEPs Are Safe

The recent attention given to the open MEP issue has led some to conclude that open MEPs are not compliant with ERISA or are otherwise problematic when this is simply not the case. As with any retirement plan, MEPs must comply with both IRS and DOL rules. Whether related or unrelated employers participate in a MEP need not have any bearing on the governance of a MEP. Open MEPs are perfectly safe if governed properly, just as MEPs that cover a bona fide group of employers and single employer plans are safe when governed properly.

Certainly, however, as noted above, the DOL might take the position that an open MEP that has failed to file the Form 5500 with audit at the employer level in past years is subject to substantial penalties. But MEPs acquiescing to the DOL's position by applying these requirements at the employer level are safe.

What Pentegra Is Doing

Pentegra has served MEPs in a fiduciary capacity for nearly 70 years. As a fiduciary, Pentegra has always focused on protecting the benefits of and acting in the best interests of the plan participants. When the law is unsettled, as in the case of open MEPs, the best course of action is not always perfectly clear. For example, is it better for participants to forego superfluous reports and audits, thereby avoiding costs that could affect long-term savings, or to do the reports and audits to avoid potentially significant governmental penalties, even though we might disagree with the legal need to do so?

In this case, we believe the proper course of action is to adopt a conservative legal stance and incur the additional expenses of applying the Form 5500 and audit requirements to individual employers when appropriate (i.e., when we believe the DOL would question the treatment of the MEP as a single plan under ERISA). Because this results in additional expense, we will continue to work with the DOL and Congress to seek both regulatory and legislative support for solutions that reduce costs while protecting participants. If and when the DOL changes its position or Congress changes the statute, the transition to a single Form 5500 and audit will be smooth and can immediately reduce costs.

About Pentegra

Pentegra is one of the oldest and largest MEP providers in the United States, having offered its longest-standing MEP—a defined benefit MEP that is currently one of the largest defined benefit plans in the

United States—since 1943. Today we serve more than 4,000 employers with over $13 billion in retirement plan assets, the majority of whom participate in our multiple employer retirement plans.

We act as a service provider, plan sponsor, named fiduciary, discretionary trustee, ERISA §3(38) investment manager, ERISA §3(16)(A) fiduciary administrator and/or third party administrator for advisors, providers, associations, and others who wish to start and operate customized MEPs. In both MEPs and single employer plans, we seek to build solutions that remove fiduciary and administrative burdens from employers. We believe the future is bright for total fiduciary outsourcing and multiple employer arrangements of all types, and we stand ready with our industry and governmental partners to implement that vision in ways that improve the lives of both employers and employees.

Robert Alin *is 1st Senior Vice President, Secretary & General Counsel of Pentegra Retirement Services. Among his many achievements, he played a lead role in persuading Congress in 1987-1989 to amend the Internal Revenue Code by adding §413(c)(4) to address funding liability in defined benefit MEPs, and has helped draft several prohibited transaction exemptions and DOL advisory opinions with respect to MEPs. Robert can be reached at robert.alin@pentegra.com.*

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