AN OFFICIAL PUBLICATION OF ASPPA

# PLAN CONSULTANT

FALL 2016

## The 'Big Wind' Behind Multiple Employer Plans

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# The 'Big Wind' Behind Multiple Employer Plans

by Pete Swisher

A venture capitalist was once asked, “What do you look for in a venture opportunity?” His answer: “A big wind, a great idea, and a simple solution.” MEPs are a simple solution with a big wind behind them, and it seems likely that they will play a significant role in the future of the retirement system. This article explores the forces behind the “big wind” and where that wind might carry us.

## CONGRESSIONAL SUPPORT FOR MEPs

Multiple bills have been presented to Congress over the past few years that are supportive of MEPs, and that support is bipartisan. Some of the bills have been updated and presented a second time. They include:

- S.A.V.E. Act of 2011, reintroduced in 2015
- SAFE Retirement Act of 2013
- Cooperative and Small Employer Charity Pension Flexibility Act of 2013
- USA Retirement Funds Act
- Retirement Security Act of 2014, reintroduced in 2015.

The proposals share an underlying premise: “open” MEPs — those open to any employer, regardless of whether they are related to other employers in the MEP — should be treated as single plans under ERISA. The purpose of such legislation is to override a 2012 Department of Labor (DOL) advisory opinion[1] that said open MEPs are not single plans for ERISA purposes, but must instead be treated as individual plans sponsored by each employer.

Here is a summary of provisions included in these proposals:

- **Open MEPs are single plans.** Open MEPs would be single plans for ERISA purposes, regardless of whether or not the adopting employers share a “pre-existing organizational relationship,” also referred to as “commonality” or “nexus” in DOL guidance.
- **No “bad apple” rule.** The “one bad apple” Treasury regulation[2] would be either eliminated or mitigated. This rule states that a disqualifying defect by any one adopting employer in a MEP disqualifies the entire MEP, and some cite this rule as a reason not to create or adopt a MEP.
- **Audit relief for new MEPs.** An audit would not be required in a startup MEP until the number of participants exceeded a certain threshold, such as 500 or 2,500. The purpose of this provision is to help spur new MEP creation, since the need for an audit is a significant hurdle in new MEPs.

## WHAT DOES IT MEAN THAT AN OPEN MEP IS NOT A SINGLE PLAN UNDER ERISA?

The practical implication of a MEP that is not a single plan for ERISA purposes is that each employer must separately satisfy ERISA’s requirements, and in particular the annual report (Form 5500, including the audit requirement for large plan filers) and ERISA Section 412 bond requirements.

The DOL’s concerns about open MEPs seem to revolve around a desire to ensure that ERISA’s protections are properly available to MEP participants. The annual report and audit are public documents intended to ensure that participants have a proper accounting from plan fiduciaries; the bond protects participants from fiduciary theft and dishonesty; therefore, by disallowing single plan treatment, the DOL ensures that these important protections remain intact.

## THE PRESIDENT’S 2016 OPEN MEP PROPOSAL

In early 2016, the White House issued a press release saying that the president would ask Congress to pass legislation allowing open MEPs to be treated as single plans under ERISA. The proposal would also allow self-employed individuals, including independent contractors, to participate in MEPs. Contractors are always excluded from plans today because of the exclusive benefit rule of Code Section 401(a)(2), which requires a plan to be available only to the employees of the employer. Contractors are not employees, so including them would be a disqualifying defect under current law.

Allowing the inclusion of contractors is thus a cool idea, though not as simple as it sounds. How, for example, would nondiscrimination testing be affected in a plan that includes contractors? Would all of ERISA’s notice requirements apply to contractors? Where would contributions come from, and how must they be tracked and accounted for? Any legislation would need to address such issues, but on its face this proposal could be a significant potential benefit for the nation’s 17 million self-employed individuals.

The president’s proposal would also include an important restriction: it would only be available to employers who have never had a plan before, or have had one fewer than three years. There are several possible motives for seeking this restriction, but the explanation offered by the White House is a desire to avoid “cannibalizing” the existing system.

The proposal would create a new plan type that would not be subject to the bad apple rule or the DOL’s commonality requirement.

## THE MOVEMENT TOWARD STATE-RUN MEPs

There is a thought pattern among some in Congress that the way to close the coverage gap is to let the states lead in creating mandates, since there is little appetite for new mandates at the federal level. Regardless of what anyone in Washington thinks, the states are

1 DOL Advisory Opinion 2012-04A.
2 Treas. Reg. Sec. 1.413-2(a)(4)(iv).

clearly moving *en masse* to require small employers to sponsor some kind of retirement plan. The typical proposal creates either a state-run MEP or a state-run individual retirement account (IRA) program with automatic enrollment ("auto-IRA") as a default. More than half of the states have proposed or are actively considering such legislation.

*DOL Support for Government-Run Open MEPs*

In 2015, President Obama directed the DOL to issue guidance in support of states' efforts to start payroll-deduct auto-IRAs and open MEPs. The DOL responded by issuing guidance in November 2015 stating that auto-IRA programs[3] are not subject to ERISA's strict provisions if they are run by a state government. At the same time, the DOL issued guidance[4] saying that the inability to treat an open MEP as a single plan for ERISA purposes did not apply to MEPs run by state governments.

The DOL's choice to favor state-run plans over plans run by the private sector might, with perfect reasonableness, be viewed as a political maneuver intended to bypass the legislature in moving the retirement system toward government control. Simple wording changes to the November guidance could have helped clear the way for a unified public-private effort to close the coverage gap and marshalled the resources of the private sector, just as the creation of Section 401(k) marshalled resources to create one of the most successful pension systems on the planet — something that government alone would never have accomplished on its own.

The point worth noting for purposes of understanding the MEP environment is that the guidance is favorable to MEPs as a tool of national retirement policy.

## A CLOSER LOOK AT THE 'WIND' BEHIND MEPs

Republicans and Democrats in both the House and the Senate are coming out in support of MEPs. The president and the DOL, in limited fashion and with a preference for government control, are supporting MEPs. State legislatures are passing or considering legislation requiring employers to have retirement plans, and considering MEPs as a default program.

Multiple employer plans are clearly being viewed by parties across the political spectrum as an important tool of social policy. Change is coming, and MEPs will be a significant factor in that change. The logical question is, why?

*MEPs are Simpler*

Some in the retirement industry may have been looking at MEPs from the wrong direction. The assumption is that creating a MEP is all about cost. But how will that be helpful? We already have low-cost vendors, and there is no room for the cheapest vendors to get much cheaper. Industry data show that pricing is on a precipitous decline due to intense competition and consolidation. Pricing, in other words, is falling rapidly even without multiple employer plans; MEPs by themselves simply will not move the cost needle much further, though they will help.

But internal plan cost is not the only problem employers want to solve. They also want to save time, energy, and headaches. They want to know that their plan is being run properly and their participants' best interests are looked out for. They want good service. And they want professional fiduciaries and service providers who accept accountability for doing so, on paper, legally. And they want all this in a nice, neat, simple, cost-effective package. That's what a MEP does: It creates a simple, cost effective way for employers to let professionals and independent fiduciaries handle the plan so they can focus on their businesses.

Since MEPs are genuinely simpler, they are a superior plan design versus a single employer plan in many respects. Put yourself in the role of an adopting employer who is being told by her advisor and TPA that ERISA is scary, the 401(k) is complicated, and the employer must appoint fiduciaries, hold meetings, read the plan document, learn rules, create processes, and document everything carefully. Most employers want no part of this; they simply want someone to handle it for them, and the extent to which this happens in a MEP — by virtue of having a central appointing authority and professional (usually) fiduciaries — cannot be duplicated in a single employer plan.

So MEPs are simpler; the simplicity is real; clients respond to it — that's why MEPs are poised for growth.

## THE REGULATORY VEIL

There are very few MEP experts for the simple reason that there are very few MEPs. To be an expert at something, one must do it often. And few in the U.S. have had a chance to do MEPs often. Misinformation therefore abounds, and most in the retirement industry feel that the sense of certainty they require is behind a veil — they can almost see it, but not quite. Yet the legal situation is not particularly complicated. Cross-testing,[5] for example, is much more complicated. And most of the uncertainty revolves around open MEPs. (I will not attempt to clear up that uncertainty here — I merely relay what is known about certain rules where there seems to be confusion.) Following is a summary of some key points that come up regularly.

3 An "auto-IRA" is a payroll-deduct IRA program with automatic enrollment. The automatic enrollment provision would ordinarily cause such a program to be subject to ERISA under DOL rules; the new guidance under 29 CFR 2510.3-2(d) relaxes the rule, but only for state-run plans.

4 Interpretive Bulletin 2015-02, 29 CFR 2509.2015-02.

5 Cross-testing is a form of non-discrimination testing under IRC Section 401(a)(4) that requires a complex methodology for calculating and testing contributions or benefits.

*Open MEPs are Not Single Plans Under ERISA*

"Open" MEPs (open to any adopting employer, whether connected to other adopters or not) that do not meet the Department of Labor's criteria for single plan treatment[6] are treated as separate plans for each employer, with all the compliance consequences this entails — in particular, the need for separate audits, ERISA fiduciary bonds and Forms 5500. All of ERISA's rules must be satisfied for such plans as if they were single employer plans. Therefore, one should not attempt to start an "open" MEP and treat it as a single multiple employer plan for ERISA purposes.

Prior to the issuance of Advisory Opinion 2012-04A, the industry was uncertain about the DOL's position on open MEPs. The industry now has certainty.

*Closed MEPs Are Single Plans Under Both ERISA and the Code*

"Closed" MEPs that do meet the DOL's criteria for treatment as a single plan operate with a single audit, bond and 5500. They are "Section 413(c) plans" under the Internal Revenue Code and single plans for ERISA purposes.

*The IRS Has its Own Rules*

The IRS rules for MEPs fall under IRC Sections 413(c) and 414(l) and the regulations thereunder. A number of old, large MEPs have been operating under these rules for decades. These are plans that predate ERISA, securities law, and most tax law. Such plans generally have favorable determination letters from the IRS going back decades, and thus enjoy a high degree of certainty that their plans, as written, are in compliance. The plan documents therefore provide a reasonable starting point for clearing up questions about the IRS rules concerning MEPs, and decades of operational history provide further clarity. Thus, there is little or no uncertainty about how to apply the IRS's MEP rules.

*The 'Bad Apple' Rule is Not So Bad*

The "one bad apple rule" of Treasury Regulation 1.413-2(a)(4)(iv) is not as big a deal as everyone seems to think it is. The rule says that any qualification failure by any adopting employer disqualifies the entire plan. Sounds scary, but how often does the IRS disqualify plans for compliance failures? Almost never. Instead, plan fiduciaries must ensure that defects are corrected in accordance with EPCRS.[7] And the preamble to the "bad apple" regulation suggests that offending adopters who refuse to correct their mistakes may be spun out and dealt with separately. The IRS disqualifies plans because of their owners' greed and stupidity, not ADP test failures.[8] Proposed legislation in Congress would eliminate or mitigate the "bad apple" rule, but it is debatable whether such legislation is actually needed.

*Treatment of Forfeitures and 414(l)*

In a MEP, do Company A's forfeitures have to be available to pay Company B's benefits? And must John Smith's 401(k) account balance be available to pay for Jane Doe's distribution, a result that is obviously nonsensical and contrary to other laws, such as the anti-alienation provision of ERISA?[9] A literal reading of Treasury Regulation Section 1.414(l) would suggest so. Here is the language [emphasis by author]:

"…(1) Single plan. A plan is a "single plan" if and only if, on an ongoing basis, **all of the plan assets are available to pay benefits to employees who are covered by the plan** and their beneficiaries… A plan will not fail to be a single plan merely because of the following:

…(iii) Several employers, whether or not affiliated, contribute to the plan,

…(v) Separate accounting is maintained for purposes of cost allocation but not for purposes of providing benefits under the plan.

…However, **more than one plan will exist if a portion of the plan assets is not available to pay some of the benefits.** This will be so even if each plan has the same benefit structure or plan document, or if all or part of the assets are invested in one trust with separate accounting with respect to each plan."

So if even "a portion of the plan assets" is not available pay just "some of the benefits," the plan is not a single plan even if it uses just one plan document for all adopters. Therefore, based on a simple reading of the regulation, Employer A's forfeitures and other assets must be available to pay Employer B's liabilities, and John's account balance must be available to pay for Jane's QDRO.

Needless to say, this interpretation makes no sense in a defined contribution (DC) plan, and would probably invalidate the existence of *all* DC MEPs, whether open or closed, if it were applied. Fortunately, the answer is fairly simple: There are long-standing MEPs with plan document language stating that forfeitures are handled on an employer-by-employer basis, and that John Smith's balance is for John only, and can't be used for Jane; and, as noted previously, these plans have favorable letters of determination going back decades. Also, forfeitures come from contributions, and contributions are determined on an employer-by-employer basis in a Section 413(c) plan (*i.e.*, a MEP), by statute.

## DB MEPs ARE A GREAT IDEA, BUT THEY'RE NOT SELLING

Defined benefit MEPs are so cool… but do not appear to be poised for growth for two reasons. First, the Section 414(l) rule (above) says that all

6 DOL Advisory Opinion 2012-04A.

7 Employee Plans Compliance Resolution System, as defined under IRS Revenue Procedures at irs.gov.

8 A failure to correct for Average Deferral Percentage test failures by December 31 of the subsequent year, thereby incurring penalties under EPCRS.

9 ERISA Section 206, which protects a participant's account from anyone who might want a piece of it under nearly all circumstances.

assets must stand behind all liabilities, thereby creating a "joint and several liability" for adopting employers that gives some new adopters pause despite the low cost and incidence of real-life liability events (like the Great Recession of 2008-2009, when some DB MEP adopting employers went belly up). Also, the accounting rules make it expensive, from a P&L expense accounting standpoint, for some companies subject to FASB[10] rules to adopt a DB MEP. Therefore, in practice, few new adopters join these programs, and no new ones are being formed. If you want a cool structure for DB plans, look instead to group trusts.

## WHERE DO WE GO FROM HERE?

It seems likely that MEPs will continue to gain traction in the marketplace. It also seems likely that some states will start MEPs, and that some associations or other groups will start new MEPs in the near future. If new legislation is passed to eliminate some of the perceived obstacles to new MEP formation, the floodgates will open, and every provider and advisor in the U.S. will suddenly want to offer MEPs. Just as "3(38)" sounded like an odd caliber of ammunition to most advisors 10 years ago, yet now is commonplace, MEPs will assume a significant role in the future of the retirement industry in the years to come. PC

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10 Federal Accounting Standards Board, the rules of which are found under the Accounting Standards Codification (ASC).