What 401(k) RESA Legislation Means For MEPS and PEPS

A WHITE PAPER BY

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By now the retirement industry recognizes that MEPs will play an expanded role in the future of the U.S. retirement system. The question for most retirement specialists is what to do about it. A study of PEPs—currently the most likely-to-pass legislative advancement of open MEPs—is a good place to start.

A stand-alone pension bill that re-introduces the concept of a PEP (Pooled Employer Plan) surfaced in the Senate recently, sponsored by Senate Finance Committee Chairman Orrin Hatch (R-Utah) and Ranking Member Ron Wyden (D-Oregon). A previous version of the bill was reported out of the Finance Committee in September of 2016 with an unprecedented vote of 26-0 and was widely considered to be a "runaway freight train," that was going to pass. The realignment of legislative priorities in the wake of the presidential election put RESA on the back burner, but it appears to have moved to the front. And on March 14, Rep. Ron Kind (D- Wisconsin) and Rep. Mike Kelly (R-Pennsylvania) introduced a House version of RESA.

Only 4% of bills ever become law, and they often go through many changes even if they do become law, so don't jump to conclusions. That said, RESA enjoys strong bipartisan support, and it is safe to place the odds at greater than 4%. A vote could even take place before the end of March.

Assume RESA passes: what would this mean for multiple employer plans (MEPs) and PEPs? How might advisors and service providers respond? What follows is a summary of the Senate Bill and its possible implications for MEPs. Note, however, that MEPs and PEPs are only one small part of RESA—this is a broad, favorable piece of legislation covering many aspects of retirement plans.

RESA Summary

Here is a simplified and legally imprecise (take your pick, precision or simplicity) summary of RESA's MEP and PEP provisions:

PEPs as a New Type of Open MEP

A PEP is a new type of open MEP1 that is a single plan for ERISA purposes. The IRS would issue model plan language. The primary requirements to qualify as a PEP include: must be run by a PPP (Pooled Plan Provider); must designate one or more bank2 trustees who are not participating employers to ensure contributions are properly collected and remitted and hold assets for safekeeping; no unreasonable restrictions, fees, or penalties.

1 "Open MEP" is a term of art referring to a plan for multiple employers that does not qualify as a single plan for ERISA purposes according to current DOL rules

2 Instead of a bank, it could also be "such other person who demonstrates to the satisfaction of the Secretary that the manner in which such other person will administer the trust will be consistent with the requirements of this section." From IRC Sec. 408(a)(2), on who can be an IRA trustee.

Electronic Delivery as the Default

The Bill would allow for electronic delivery to PEP participants—but does NOT make the same allowance for other MEPs or any other plan types. The PEP would be the only structure with a free statutory pass to reduced cost in this respect. This provision is therefore a significant "un- leveler" of the playing field.

The history of electronic delivery proposals in Congress (there have been many) is that they have been firmly opposed by consumer groups like AARP, and therefore by the DOL.

PEP Adopting Employers are Responsible for Selection and Monitoring of Fiduciaries

In order to qualify as a PEP:

> "The terms of the plan" must "(iii) provide that each participating employer retains fiduciary responsibility for…the selection and monitoring in accordance with section 404(a) of the person designated as the pooled plan provider and any other person who, in addition to the pooled plan provider, is designated as a named fiduciary of the plan."

What does this actually mean? The answer will be a primary determinant of how a PEP may be structured.

There are two key aspects to the basic governance structure of a MEP (or any plan, for that matter):

- Who can be the sponsor?
- Who is responsible for appointment, monitoring, and compensation of fiduciaries and service providers?

There is nothing in the Bill to suggest that current law will change with respect to who can be the plan sponsor (as defined in ERISA Section 3(16)(B))—it must be an employer or a "group or association" of employers[3]. Many in the industry assume that service providers will be able to sponsor their own PEPs—perhaps this will end up being true, but there is no evidence of it in the Bill. The Bill could have, for example, amended ERISA Sections 3(5) and/or 3(16)(B), the definitions of "employer" and "plan sponsor," but does not do so.

What the Bill does make clear is that the adopting employers in a PEP remain responsible for prudent appointment and monitoring of the PPP and any other named fiduciaries. What might the DOL make of this provision in subsequent regulations?

One approach might be the one embodied in an informal comment from a private conversation with a DOL official several years ago: "We (the DOL) don't see how you can run these things without a client board of directors." A client board is a nice, clean governance structure for appointing and monitoring the PPP, and this approach fits well

[3] See the definition of "employer" in ERISA Section 3(5)

with the DOL's long-standing views on independence[4] and "control in fact"[5] by adopting employers. An uncompensated lead employer (in a related group of employers) or a membership association acting as a fiduciary are also tried-and-true structures. A PEP could presumably follow these approaches with confidence.

An alternative interpretation is that the intent of the law is that simply choosing to join a PEP is the same as appointing and monitoring the PPP[6]. Under current and historical DOL guidance, it is difficult to conceive of the DOL supporting this interpretation: there is clearly a difference between choosing to join a program in which the fiduciaries are already chosen by someone else versus actually choosing the fiduciaries. But if "joining = appointing" is the actual intent of the law, and if the final statute supports this interpretation, it could very well be that PEP governance will in fact take a dramatic departure from established ERISA governance in this respect.

Service providers and advisors tend not to like the "independent board made up of adopting employers" answer because a board can be hard to form and can fire them, so it will be interesting to see how the dialogue plays out on this subject.

Employer Choice of Investments

The adopting employers also remain responsible for investment selection and monitoring to the extent not already dictated by the PPP or other named fiduciaries. This is an interesting provision. On the one hand, the entire point of a MEP is efficiency, economies of scale, and professional management. On the other hand, some employers like choosing their own investments. One could argue that such employers should simply stick with a single employer plan, but the PEP structure allows for choice. Note that there is nothing in current MEP rules to prevent such choice; it is simply that current MEPs, as a rule, have a single fund menu. In other words, this provision, may be unnecessary in that current law already allows it.

Converting Current MEPs into PEPs

It appears that closed MEPs would not be convertible into PEPs, as the Bill is written, because they meet the nexus and control requirements and thus fall into a separate category. Programs other than closed MEPs are convertible to PEPs if the plan administrator so elects. This is a negative for existing closed MEPs, because PEPs get a free pass on electronic delivery, whereas other plans do not. One result might therefore be that closed MEPs deliberately begin accepting adopting employers outside of the plan's "nexus" so as to be able to convert to a PEP. This seems a bit toilsome, so one hopes any final rules would make it unnecessary, since the existing closed MEP structure works well.

Pooled Plan Provider (PPP)

In order to qualify as a PEP, the PEP must be run by a PPP, who is a named fiduciary identified in the plan document and is also the ERISA Section 3(16) administrator, responsible for ensuring the plan meets qualification requirements and that all fiduciaries are bonded as applicable,

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[4] To assemble a definition of "independent," see DOL Reg. Sec. 2550.408b-2(e) and (f); also the 5%/2% rules of the SunAmerica Letter, DOL AO 2001-09A, and the definition of "independent" Section VIII(f) of PTE 2016- 01 (the 2016 BICE).

[5] See DOL Advisory Opinion 2012-04A for discussion of the control requirements applicable today.

[6] In fact, the genesis of the provision is likely DOL AO 2012-04A, in which TAG argues this exact approach (which the DOL rejected).

registers with the DOL as a PPP, is subject to audit by the DOL, and acknowledges named fiduciary and 3(16) status in writing.

"Bad Apple" Rule Relief

Both closed MEPs and PEPs are able to provide for the spinoff and separate correction of adopting employers who do not comply with laws, regulations, or plan policies. In other words, the so-called "bad apple" rule[7], which says that a disqualifying defect by one adopter disqualifies the entire MEP, is effectively neutralized. Those familiar with MEPs today have always followed this approach, based on language that suggests the possibility in the Preamble to the Regulation, but statutory clarification would of course be nice.

1,000 Participant Audit Threshold

Audits are expensive, and small plan filers who join a MEP—only to be subjected to the new trouble and expense of audits—may find the audit to be a significant negative. The Bill therefore provides modest relief for startup MEPs in that no audit is required until the plan reaches 1,000 participants, as long as each individual adopter would otherwise be a small plan filer.

408(c) IRA Trusts

"What is Section 408(c)?" you may ask. IRC Section 408 covers IRAs, and 408(c) refers to a form of common trust fund:

> (c) Accounts established by employers and certain associations of employees
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> A trust created or organized in the United States by an employer for the exclusive benefit of his employees or their beneficiaries, or by an association of employees…for the exclusive benefit of its members or their beneficiaries, shall be treated as an individual retirement account…The assets of the trust may be held in a common fund for the account of all individuals who have an interest in the trust.

In other words, a 408(c) IRA trust can be a PEP, or part of a PEP. It is too soon to tell what this actually means. Can a PEP include SEPs, SIMPLE-IRAs, traditional IRAs, and Roth IRAs? It would appear so. If the industry can figure out how to scale the delivery of services to payroll-deduct IRA clients, we might see serious movement to close the coverage gap.

403(b)s and 457s Left Out

Legal consensus today is that 403(b)s and 457(b)s can be MEPs, but this is based on consensus interpretation (and existing plans), not statutory certainty. It would be nice if they would include these plan types, and the failure to do so un-levels the playing field in that for-profit employer MEPs/PEPs/trusts get the benefits of RESA, but not-for-profits don't. This does not mean there cannot be not-for-profit MEPs, only that, for example, the electronic delivery advantage of PEPs—and the PEP structure overall—are unavailable to not-for-profit employers.

Cost vs. Responsibility as the Driving Factors and How this Affects the PPP

Assume there are only two possible objectives of a PEP: 1) achieve the lowest possible cost; 2) fulfill fiduciary duties. In today's marketplace, these two objectives are not especially compatible. The best way to fulfill fiduciary duties consistently is to have professional fiduciaries run the plan and accept broad responsibility for details. The best way to reduce visible costs is to

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7 Treasury Reg. Section 1.413-2(a)(3)(iv)

push fiduciary responsibilities on the client. Professional fiduciaries cost more, and no amount of scale can change that.

Now assume you are the Pooled Plan Provider to a PEP. You are broadly responsible for compliance with laws, regulations, and the plan's governing document(s). The law makes clear that you can expect visits from the DOL and IRS. You have to register with the DOL and accept named fiduciary and 3(16) administrator status in writing. What, therefore, is your business model? Option 1: charge a pittance to keep it cheap; Option 2: do a thorough, professional job, and charge enough to make that possible.

People often misunderstand the advantages of a MEP—they think it must be primarily about low cost. But super-low cost is simply not compatible with governance by professional fiduciaries who are operating under high regulatory scrutiny. MEPs and PEPs are more about simplicity and outsourcing for employers at a reasonable cost, but they cannot be about radically undercutting market pricing, as many suppose. Stated another way, people tend to think MEPs are a cost play, when in reality they are a value play. PPPs who misunderstand this will likely pay a heavy price themselves.

The New EBSA Chief Wrote RESA

This may be an exaggeration that fails to give credit where due to the team effort of authorship, but it has been widely reported that the new Assistant Secretary of Labor for EBSA[8], Preston Rutledge, was a principal author of RESA during his time in the Senate. One conjectures that he may come to the game well-informed and possessed of opinions on how best to write regulations under RESA, should it pass.

About the Author

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