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Pooled Employer Plans – FAQs for U.S. Employers

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In this article, the authors discuss frequently asked questions about a new retirement vehicle called a "Pooled Employer Plan."

New legislation, in the form of the "SECURE Act," greatly enhances the ability of employers (particularly small and medium-sized employers) to maintain retirement programs for their employees. In the past, legal impediments to maintaining "multiple employer plans" for groups of unrelated employers have meant that many small and medium-sized employers were left to struggle with the cost, complexity, and legal exposure associated with maintaining a single employer plan for their employees or to forgo having a plan at all.

The SECURE Act provides for the creation of a new retirement vehicle called a "Pooled Employer Plan" ("PEP"), in which unrelated employers may participate and which is sponsored by a "Pooled Plan Provider" ("PPP").

As outlined in the FAQs below, the PPP will typically be responsible for most fiduciary and administrative duties related to the PEP, freeing participating employers from the burden of those responsibilities and enabling them to limit their legal exposure for such matters.

In addition, PEPs offer the possibility of lower costs than single employer plans on account of the pooling of assets and attendant economies of scale, as well as certain streamlined reporting and disclosure requirements.

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WHAT EXACTLY IS A PEP?

A PEP is a type of retirement plan that meets certain requirements (outlined below) and that is maintained to provide benefits to employees of two or more unrelated employers. A PEP may be either a qualified defined contribution plan under Section 401(a) of the Internal Revenue Code (the "Code") or consist of individual retirement accounts described in Section 408 of the Code. The PPP responsible for maintaining a PEP may be one of the participating employers, or may be an unrelated entity, such as an insurer or financial institution, that meets certain requirements described below.

Plans that satisfy the PEP requirements are characterized as open multiple employer plans and are treated as a single plan for purposes of satisfying the requirements of the Employee Retirement Income Security Act ("ERISA").

WHAT MAKES A PEP DIFFERENT FROM A SINGLE EMPLOYER-SPONSORED 401(k) PLAN AND FROM MULTIPLE EMPLOYER PLANS OF THE PAST?

In a single employer-sponsored 401(k) plan, participation is limited to the employer/sponsor and members of its controlled group. The plan administrator is responsible for ensuring the plan satisfies all of ERISA's requirements, including filing an annual report (Form 5500) with the U.S. Department of Labor ("DOL"), as well as the requirements of the Code.

In multiple employer plans ("MEPs"), two or more unrelated employers participate. Historically, the DOL took the view that if multiple, unrelated employers shared a common nexus (such as industry or geography), the arrangement would be 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.

In 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 to maintain its own plan that was required to independently satisfy ERISA's requirements, including filing a separate Form 5500 and obtaining an independent audit, if applicable. 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.

The SECURE Act essentially reverses these DOL positions by creating the PEP (a type of open MEP), which is treated as a single plan for purposes of ERISA, affording it the advantages described below, including streamlined administration and reporting, and which may be sponsored by a bank, insurance company or other financial services firm.

In addition, in the past, a risk for employers participating in MEPs had been the Internal Revenue Service's ("IRS") "one bad apple" rule; the IRS took the position that if one employer failed to meet the qualification requirements for its portion of the MEP, the entire MEP could be disqualified, even with respect to unrelated employers that had satisfied their obligations. The SECURE Act significantly reduces this risk to innocent employers; a PEP will not be treated as failing the qualification requirements solely because a single employer fails to satisfy those requirements so long as the PEP provides for the transfer of the offending employer's plan assets to one of certain specified arrangements.

A PEP program offers potentially significant advantages over a traditional single employer plan that certain small to medium-sized employers may find appealing, as a consequence of the SECURE Act's removal of some of the limitations previously associated with MEPs.

HOW SOON WILL PEPS BE AVAILABLE?

The earliest that PEPs will be available is for plan years beginning on January 1, 2021.

WILL PARTICIPATING IN A PEP BE EXPENSIVE OR DIFFICULT?

In order to offset startup costs, the SECURE Act provides 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 that the plan is effective. Employers should consult with their tax advisors for additional details.

Adopting employers will be required to take actions necessary to enable the PPP to administer the plan and to meet legal requirements (including providing disclosures and related information), but these disclosures may be provided electronically and requirements will be designed so that the costs imposed on PPPs and adopting employers are reasonable. A model plan is expected to be issued shortly.

WHAT ARE THE REPORTING REQUIREMENTS FOR A PEP?

Typically, an employer, as the sponsor of a retirement plan, would be required to file a Form 5500 with the DOL with detailed information about the plan. One advantage of a PEP is that only one Form 5500 needs to be filed for the entire PEP – individual employers are not required to file their own Form 5500s. PEPs may also qualify for simplified reporting, which avoids the need for an annual audit in connection with filing Form 5500. Simplified reporting will be available if no single employer participating in the plan has 100 or more covered participants, and there are fewer than 1,000 participants in the plan overall.

WHO CAN AN EMPLOYER USE AS A POOLED PLAN PROVIDER?

PPPs will need to be registered with the IRS and the DOL before beginning their PEP operations. However, the registration process is not open yet, so no list of PPPs is available. In addition to registration, the PPP must:

- Be designated by the PEP as (a) a named fiduciary, (b) the plan administrator, and (c) the person responsible to perform all administrative duties necessary to ensure that (i) the PEP meets the applicable requirements of ERISA and the Code, and (ii) each employer in the PEP takes such actions as necessary for the PEP to meet the such requirements;

- Acknowledge in writing that it is acting as a named fiduciary and plan administrator with respect to the PEP; and

- Be responsible for ensuring that any person or entity who handles assets of, or who is a fiduciary to, the PEP is bonded in accordance with ERISA Section 412.

The Department of Labor issued proposed regulations describing its registration process for PPPs on September 1, 2020. Under the proposed regulations, PPPs would be required to electronically file an initial registration before beginning operations (that is, before marketing PPP services or publicly offering a PEP), supplemental filings in certain circumstances, and a final filing once its last PEP was terminated and ceased operations. The registrations would be publicly available.

WHAT TYPE OF FIDUCIARY LIABILITY WILL AN EMPLOYER THAT ADOPTS A PEP HAVE WITH RESPECT TO THE PEP?

Generally, fiduciary responsibility for a PEP's administration and investment of the PEP's assets resides with the PPP and other named fiduciaries designated by the PPP. However, an employer will be responsible for certain decisions.

Selecting and Monitoring the PPP and PEP Fiduciaries

An employer is responsible for prudently selecting the PPP and other named fiduciaries of the PEP and prudently monitoring their ongoing performance. Prudence generally requires evaluating the PEP's qualifications and track record, as well as its fees and expenses relative to other PEP options available. Prudence would not mandate selection of the lowest cost provider or the best performing provider.

An employer may reasonably factor into its decision the various qualitative considerations that are important or relevant to the employer's employees, such as PEP design and features, educational resources and other services offered under the PEP. The employer may also consider factors that it considers important, such as familiarity with the PEP sponsor and convenience, as long as the decision is ultimately driven by what is in the best interests of its employees.

Monitoring Investments or Monitoring the Fiduciary Responsible for Investments

A PEP may offer a participating employer the opportunity to choose which investment options and features will be made available to its employees. If the employer opts to make the decisions regarding the investment options offered to its employees under the PEP, the employer will be an ERISA fiduciary with respect to the selection of those investment options and the ongoing monitoring of them.

The duty of prudence requires a fiduciary making investment decisions to have the requisite expertise for the investment decisions at hand. An employer may supplement its knowledge of investment matters by consulting with investment professionals. Alternatively, an employer may choose to leave the selection of the investment lineup and other investment decisions entirely to the PEP fiduciaries with professional investment expertise, thereby limiting its fiduciary responsibility to the selection and monitoring of the PEP's named fiduciaries.

Protections

ERISA Section 404(c) and the regulations issued thereunder provide a fiduciary safe harbor for investments directed by plan participants. To the extent that a plan participant directs the investment of his or her own account under a plan that meets the requirements of the Section 404(c) rules, the participant is not treated as a fiduciary, and parties who are otherwise fiduciaries to the plan are relieved of responsibility and liability for such investment decisions.

To meet the requirements of ERISA Section 404(c), the plan must offer participants the opportunity to choose among "a broad range of investment alternatives." The DOL has noted that investment companies often charge lower fund fees for plans with greater asset accumulations. One of the attractive features of a PEP is that by pooling participant and plan assets into one large plan, rather than many small plans, a PEP is better positioned to enable small businesses to give their employees access to the same low-cost share classes in a broad range of funds as are available to the plans of large employers.

An employer participating in a PEP should not have exposure for fiduciary breaches by the PEP's named fiduciaries unless the employer fails to take action to terminate its participation in a PEP when prudent to do so and the employer's plan suffers a loss as a result of a fiduciary breach by one of the PEP's named fiduciaries.

WHAT TERMS MUST A PEP INCLUDE?

PPPs will generally be responsible for drafting plan terms in accordance with applicable law. A PEP must designate a PPP and one or more trustees. In addition, the PPP must provide, as described above, that each adopting employer retains fiduciary responsibility for selecting and monitoring the PPP and any other named fiduciaries and, unless otherwise delegated, the investment and management of the plan assets attributed to the employer.

A PEP must also contain provisions beneficial to adopting employers, including that employers in the plan are not subject to penalties, unreasonable restrictions or fines for ceasing to participate, receiving distributions or otherwise transferring plan assets based on the rules for plan mergers and transfers and that the PPP must provide required disclosures to adopting employers. These terms will be set forth in the yet-to-be-provided model plan.

WILL THERE BE ANY ADDITIONAL GUIDANCE ISSUED ON PEPS?

Though the IRS and the DOL have been authorized to issue additional guidance related to PEPs, only limited guidance on proposed registration requirements has been issued. Until guidance is issued, employers and PPPs will not be treated as failing to meet the necessary requirements so long as they comply in good faith with a reasonable interpretation of the applicable law.