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PEPs and MEPs: Compliance and Fiduciary Considerations Under the SECURE Act

The pooled employer plan (PEP) and multiple employer plan (MEP) provisions are among the most important retirement plan features of the Setting Every Community Up for Retirement Plan Enhancement (SECURE) Act of 2019, which took effect Jan. 1, 2021.

These plan structures have created excitement because they allow employees of more than one employer to participate in a single retirement plan, with the goal of limiting employer compliance responsibilities and fiduciary liability by outsourcing to a PEP or MEP provider. Also, the Department of Labor (DOL) enhanced defined contribution MEP coverage prior to the SECURE Act with the issuance of regulations that clarified the meaning of "employer" under ERISA Section 3(5) to include a "bona fide" employer group or association and "bona fide" professional employer organization (PEO).

However, there is some confusion about the differences between these combined plan structures and, in particular, the fiduciary responsibilities of the new PEP and MEP providers and participating employers. These responsibilities must be closely examined and considered before deciding to establish or participate in a PEP or MEP.

What Are PEPs?

Introduced under the SECURE Act, PEPs are a new retirement plan vehicle that allows **unrelated** employers to band together to participate in a single defined contribution plan sponsored by a "Pooled

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Plan Provider" (PPP) registered with the DOL and IRS in order to offer a PEP to employers. A PPP can be a bundled recordkeeper or third-party administrator (TPA), independent fiduciary, insurance company, mutual fund management firm, plan investment advisory firm or broker-dealer. Currently, 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 PEP provisions.

Benefits

Key benefits include the following: a single Form 5500 filing and a single audit for all employers that are part of the PEP; a single ERISA bond to cover all assets, giving participating employers the ability to avoid certain fiduciary and administrative responsibilities; the ability for PPPs to create efficiencies through pooling without the need for plans in the pool to satisfy the "commonality" requirement applicable to MEPs.

Fiduciary Responsibilities

PEPs are sponsored by a PPP who is the named fiduciary and ERISA Section 3(16) plan administrator responsible for most fiduciary and administrative duties related to the PEP. However, participating employers are still responsible for and have fiduciary liability with respect to selecting the PPP and other named fiduciaries of the PEP (and must be prudent in making that selection for their employees) and prudently monitoring the ongoing performance of the PPP and other PEP fiduciaries. Prudence generally requires evaluating the PPP and PEP's qualifications and track record, as well as its fees and expenses relative to other PEP options available.

In effect, the SECURE Act PEP rules change current fiduciary structures by shifting fiduciary responsibilities away from the employer and onto the PPP and its service providers, who may not have accepted fiduciary responsibility in the past (for example, TPAs, record keepers, banks acting as trustees, payroll providers, broker-dealer firms). Also, investment fiduciaries who want to serve as a PPP will need to accept fiduciary responsibility for administrative functions. Historically, they have not been involved in administrative functions and will have to develop expertise in this function. This is a key consideration for employers, as those firms or entities that are now the plan's fiduciaries may not have served in that capacity before. Another concern is that the PPP acting in the capacity of the plan's primary fiduciary, the Plan Administrator, may also be serving as the TPA and recordkeeper which is the plan's primary service provider. Because conflicts may occur, there is an increased need to have an assessment of these issues by independent ERISA counsel and to determine if fees, expenses, and services are reasonable.

What Are MEPs?

MEPs allow **related** businesses to band together in a manner similar to PEPs to participate in a single retirement plan, and file a single Form 5500, and conduct a single audit for all participating employers. A single ERISA bond covers all employers.

Benefits and Restrictions

In addition to the simplified filing, auditing, and bonding requirements, MEPs are now easier to establish then they were prior to the SECURE Act. The "one bad apple" rule, where the compliance failures of one employer could disqualify the entire plan, has been eliminated by the SECURE Act. Additionally, smaller MEPs (and PEPs), with fewer than 1,000 participants, are exempt from a potentially expensive audit requirement, as long as no one employer exceeds 100 participants.

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It has been the DOL rule since 2012 that Open MEPs, which are open to any employer that wishes to participate (without a requirement for commonality among the participating employers), do not constitute a single plan for ERISA purposes and are therefore treated as an aggregation of individual plans because the commonality test is not met. For example, a TPA sponsors a plan, and the only common factor among participating employers is that they are clients of the TPA. A Form 5500 is filed for each participating employer's portion of the plan; financial audits are prepared on an individual basis; each participating employer plan must have its own fidelity bond; and each employer has fiduciary liability for its portion of the plan.

However, the DOL issued MEP regulations in 2019 that made it easier for a "bona fide" employer group or association and a "bona fide" Professional Employer Organization (PEO) to sponsor a combined 401(k) or other defined contribution plan. A PEO is a human resources company that contractually assumes certain employer responsibilities of its client employers.

The regulations relaxed the "commonality" threshold by requiring only that the employer-members of the group or association either be in the same trade, industry, line of business or profession, or have a principal place of business within a single state or single metropolitan area. The regulations also make clear that the primary purpose of the group or association can be MEP sponsorship, as long as there is at least one other substantial business purpose. A "substantial" business purpose can include the promotion of common business interests within the employers' industry or geographic community.

However, there are still some restrictions in order to qualify as a "bona fide" Group or Association. For example, the group or association must have a formal organizational structure (e.g., as evidenced through bylaws or otherwise) and must be controlled by the employer-members, and participation cannot be open to the workforces of non-members. Also, to ensure that the group or association is actually sponsored by employers for the purpose of providing benefits and not by a service provider as a business enterprise, the regulation makes clear that, unlike PEPs, financial services firms, recordkeepers and third party administrators cannot act in the group or association capacity.

Also, under the DOL regulations, a PEO is only considered "bona fide" if it (i) performs "substantial employment functions" on behalf of its client employers that adopt the MEP, (ii) has substantial control over the functions and activities of the MEP, as the "plan sponsor," the "plan administrator," and a "named fiduciary" (as those terms are used under ERISA), (iii) ensures that each client employer that adopts the MEP has at least one employee who is a participant under the MEP, and (iv) ensures that participation in the MEP is available only to employees and former employees of the PEO and client employers.

Governance Requirements

The DOL regulations emphasize that in order to meet the requirement that the group or association is controlled by the employer members, the employer members would not be required to exercise day-to-day control over the operations of the group or association. Instead, DOL states that employer members would be deemed to have sufficient control over the group or association if they (a) regularly nominate and elect members of the group or association's governing body, (b) retain authority to remove elected members of the group or association's governing body, and (c) have the authority to approve or veto decisions regarding the formation, design, amendment, and termination of the MEP.

As with bona fide groups or associations of employers, the DOL Regulations provide that bona fide PEOs may act as "employers" under ERISA for purposes of sponsoring a MEP. This is premised upon DOL's position that PEOs can act "indirectly in the interest of an employer" (i.e., their client employers) and

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therefore meet the ERISA definition of “employer” with regard to the MEPs that they sponsor and administer for the benefit of employees of their client employers.

For most PEOs, the most challenging DOL requirement to be considered “bona fide” is establishing whether they perform “substantial employer functions” on behalf of the client employers that adopt the MEP. Under the DOL Regulations, whether a PEO performs substantial employment functions on behalf of its client employers is determined on the basis of a “facts and circumstances” test. Fortunately, the Regulations contain a “safe harbor” whereby a PEO will be considered to perform “substantial employment functions” on behalf of client employers that adopt the MEP if it meets four specific criteria with respect to each client employer that participates in the MEP.

Fiduciary Responsibilities

The DOL regulations include important requirements regarding the manner in which MEPs are managed. In this regard, DOL emphasizes that the group or association, or PEO (as the case may be), must act as plan sponsor, a “named fiduciary,” as defined under section 402 of ERISA, and “plan administrator” as defined under ERISA section 3(16), and be responsible for the standard reporting, disclosure, and fiduciary obligations that apply to those roles. Moreover, DOL points out that the group or association, or PEO, must act as the “responsible plan fiduciary” as defined under DOL’s regulation at 29 CFR 2550.408b-2 for purposes of selecting service providers and reviewing their compensation disclosures. Therefore, individual employers participating in the MEP would not be required to review such compensation disclosures.

However, DOL emphasizes that participating employers **retain an obligation** to choose and monitor the arrangement, overseeing the activities of the group or association, or PEO, and other fiduciaries of the MEP, and forwarding required contributions to the MEP. In this regard, DOL expects that participating employers will be furnished with periodic reports on the management and administration of the MEP, including information on fees and expenses paid to the MEP’s service providers.

Litigation and Regulatory Activity

There are strict governance requirements and potential fiduciary violations contained in the MEP regulations and SECURE Act PEP rules that could result in litigation and adverse regulatory activity, including audits by DOL or IRS. Cases have been filed and there have been large settlements already against providers of “bona fide” group or association MEPs and PEO MEPs. Because MEPs and PEPs aggregate plan money, they are targets for plaintiff lawyers given the amount of assets in those plans.

MEP and PEP litigation is similar to single employer 401(k) or 403(b) litigation in that the basic allegations relate to excessive fees and imprudent investments. However, there are special issues unique to such plans that should be examined. Most importantly, who are the fiduciaries in the MEP and PEP structure that have fiduciary responsibility for the “money” issues (fees and fund performance)? The MEP sponsor is generally, and the PEP PPP is required to be, the ERISA plan administrator and named fiduciary. In addition to the group or association MEP or PEO MEP and PEP, the members of their governing board and investment committee are the individuals normally sued, since they are ultimately responsible for the selection and monitoring of all investment options.

Also, a feature that separates MEP and PEP cases from single employer fee cases is that MEP and PEP providers receive compensation from the plans while 401(k) employer sponsors generally do not, and some providers are compensated at least in part for the fiduciary liability they assume by having discretion over plan administration. PEPs have their own set of issues. For example, registered

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investment advisors and broker-dealers are allowed to serve in a fiduciary capacity as the PEP's PPP, and providing investment services to the plan and managing assets for a fee while serving as the PPP creates the potential for entering into an ERISA- and IRS-prohibited transaction that disallows a plan fiduciary from receiving compensation in connection with transactions involving plan assets.

On the other hand, it is important to emphasize that participating employers are responsible under ERISA's fiduciary rules for selecting and monitoring the MEP and PEP sponsor and its other responsible fiduciaries, so employers have to consider carefully if enough information is communicated by the MEP or PEP in order to evaluate the prudence of the sponsor's selection and continuing performance. For example, according to DOL, the participating employer's duty to periodically monitor ongoing management and administration of the MEP includes review of information similar to DOL's required provider-to-sponsor disclosure requirements under ERISA section 408(b)(2); failure to provide that information may justify or require a decision to cease participation in the MEP.

Key Takeaways

Under the SECURE Act, ERISA, and DOL regulations, sponsors of MEPs and PEPs have strict governance and fiduciary responsibilities. Participating employers retain a fiduciary obligation and liability for making sure that the sponsor of the group or association MEP, PEO MEP or PEP has been prudently selected and is operating the plan in a prudent manner and in the best interests of plan participants.

As a potential defense to litigation and agency examinations, sponsors and participating employers should have in place robust governance practices and comprehensive operational compliance procedures that provide evidence of a thorough investigation and an independent validation of procedural and substantive process standards that demonstrate that the plan fiduciaries and participating employers have acted in a prudent manner. Experienced ERISA counsel knowledgeable in such matters can provide an independent assessment of the plan's procedural and operational compliance practices and issue a written report that provides comfort to the group or association MEP, PEO MEP or PEP that the plan has established the requisite plan management, governance and internal operational controls to effectively defend the plan against litigation or an investigation by the DOL or IRS. It also serves as a basis for participating employers to satisfy their ERISA fiduciary responsibility to make sure the sponsor has been prudently selected and continues to run the plan in a prudent manner.

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