Consider Fiduciary Duties In New Combined Retirement Plans

By **Jeffrey Mamorsky** (August 5, 2021)

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The pooled employer plan and multiple employer plan provisions are among the most important retirement plan features of the Setting Every Community Up for Retirement Enhancement, or Secure, Act, which took effect Jan. 1.

Now that the U.S. Department of Labor is accepting registration from pooled plan providers, pooled employer plans are being established by major financial institutions and flooding the market at a very fast clip, since, for the first time ever, financial services firms can sponsor a single 401(k) plan for unrelated employers.

Eighty-nine initial and supplemental pooled plan provider, or PPP, registrations have been filed with the DOL since January. There have been 11 filings in June and 17 filings in July by major vendors.

Additional registrations are expected to continue at a steady pace.

There is no DOL approval process — only a registration of intent to operate a pooled employer plan, or PEP, by the PPP — even though the Secure Act contains strict PPP and participating employer fiduciary responsibility requirements discussed below.

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 multiple employer plan provider.

Also, the DOL enhanced defined contribution multiple employer plan, or MEP, coverage prior to the Secure Act with the issuance of regulations that clarified the meaning of "employer" under the Employee Retirement Income Security Act, Section 3(5), to include a bona fide employer group or association and bona fide professional employer organization, or 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 PPP registered with the DOL for this purpose.

A PPP can be a bundled record-keeper, third-party administrator, 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 multiemployer 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; and

- 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 plan.

However, participating employers are still responsible and have fiduciary liability for selecting the PPP and other PEP fiduciaries, and for prudently monitoring their ongoing performance.

In effect, the Secure Act's PEP rules shift 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, investment fiduciaries who want to serve as a PPP will need to accept fiduciary responsibility for administrative functions and will have to develop expertise in this area.

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 must act in the capacity of the plan administrator, which is the plan's primary fiduciary, and may also be serving as the third-party administrator, which is the plan's primary service provider. As such, conflicts may occur.

What Are MEPs?

MEPs allow related businesses to band together in a manner similar to PEPs to participate in a single retirement plan, requiring one Form 5500 and one 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 than 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 single employer exceeds 100 participants.

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.

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 PEO to sponsor a combined 401(k) or other defined contribution plan.

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.

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 nonmembers.

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 regulations make clear that — unlike PEPs — financial services firms, record-keepers and third-party administrators cannot act in the group or association capacity.

Governance Requirements

The DOL regulations provide that employer members are deemed to have sufficient control over the group or association if they

- Regularly nominate and elect members of the group or association's governing body;

- Retain authority to remove elected members of the group or association's governing body; and

- Have the authority to approve or veto decisions regarding the formation, design, amendment and termination of the MEP.

Also, bona fide PEOs may act as employers under ERISA for purposes of sponsoring a MEP.

This is premised upon the DOL's position that PEOs can act indirectly in the interest of their client employers, and therefore meet the ERISA definition of "employer" with regard to the MEPs that they sponsor and administer for the benefit of their client's employees.

PEOs are considered bona fide if they perform substantial employer functions on behalf of the client employers that adopt the MEP.

Fiduciary Responsibilities

The DOL regulations include important requirements regarding the manner in which MEPs are managed.

In this regard, the DOL emphasizes that the group or association, or PEO, as the case may be, must act as the plan sponsor, "named fiduciary," as defined under ERISA Section 402, and "plan administrator" as defined under ERISA Section 3(16). And they must be responsible for the standard reporting, disclosure, and fiduciary obligations that apply to those roles.

The DOL emphasizes that participating employers retain a fiduciary obligation under ERISA to prudently choose and monitor the activities of the group or association, or PEO, and other fiduciaries of the MEP, and therefore have to consider carefully if enough information is communicated by the MEP or PEP in order to evaluate the prudence of their selection and continuing performance.

In this regard, the 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 the Secure Act PEP rules that could result in litigation and adverse regulatory activity, including audits by the DOL or the Internal Revenue Service.

Cases have been filed and there have been large settlements already against providers of bona fide group or association MEPs and professional employer organization MEPs.

Because MEPs and PEPs aggregate plan money, they are targets for plaintiff ERISA class action 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.

The MEP sponsor is generally, and the PEP PPP is required to be, the ERISA plan administrator and named fiduciary. In addition to the MEP or 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, participating employers may be sued if there is little or no documentation that they have prudently selected and monitored the management and administration of the MEP or PEP.

Moreover, 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) single 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 investment advisors and broker-dealers are allowed to serve in a fiduciary capacity as the PEP's PPP. 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.

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 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.

The procedures should 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 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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