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Employee Benefit Plan Review

Small Business and Retirement Savings: The Push for Multiple Employer Plans

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While the overwhelming majority of workers at large U.S. companies can participate in tax-favored retirement plans, coverage falls rapidly for smaller employers, whose owners are discouraged by the cost, complexity, and potential legal risk of qualified plans. Alternatives such as "Simplified Employee Pensions," "Simple Retirement Accounts," and "deemed IRAs" have made little visible headway. Some states have reacted by adopting laws – only partially implemented at this point and facing legal challenges – to compel employers without retirement plans to make state-run IRA-like savings programs available to their workers. Many others have adopted or are considering similar legislation, though generally without mandatory features.[1]

Multiple Employer Plans

Federal regulators and lawmakers have been moving toward making plans more attractive for small business by expanding a previously obscure concept: the "multiple employer plan," which is a single plan in which numerous small, unrelated companies sign up for a centrally administered retirement plan whose sponsor takes on the burdens of choosing investment providers, tracking contributions and account balances, communicating with participants, making distributions, dealing with government filing requirements, and resolving claims disputes.

The name "multiple employer plan" is somewhat arbitrary. It refers not to all plans covering employees of more than one employer but to one of a particular type. A plan is a multiple employer plan, rather than something else, if it satisfies the following criteria:

- The participating employers are not members of the same controlled group (generally, a group of incorporated or unincorporated trades or businesses with at least 80 percent common ownership). A plan that includes only members of a controlled group is by definition a "single employer plan" because all members of the controlled group are considered a single employer.
- A multiple employer plan is not established and maintained under a collective bargaining agreement between a union and the companies that employ union members. A collectively bargained plan for unrelated employers is called a "multiemployer plan." Multiemployer plans have a long history and are subject to rules that differ markedly from those for single employer plans.
- A multiple employer plan is a "single plan," that is, all of the assets of the plan are available to pay benefits to any participant. If different employers have different pools of assets that can be drawn on only for their own employees, the plan is an "aggregation" of single employer plans. As will be discussed, the differences between multiple

employer plans and aggregations are significant, but it is not always a simple matter to distinguish one from the other.[2]
- A multiple employer plan is maintained by an "employer," a term whose meaning, as we shall see, is not straightforward. The entity that "maintains" a plan can be thought of as its "controlling employer;" it establishes the terms of the plan, deals with participating employers, handles plan administration, and oversees plan investments. If the entity is an "employer" and the plan meets the other criteria listed above, the plan is a multiple employer plan; otherwise, it is an aggregation of single employer plans.

For most purposes, a multiple employer plan is subject to the same ERISA and Internal Revenue Code rules as a single employer plan. For example, it files only one Form 5500 annual report, and, if it is a defined benefit plan, is subject to the same minimum funding standards as single employer plans rather than to the separate standards for multiemployer plans.

Multiple employer plans already occupy niches in the retirement universe. For instance, some large charitable organizations maintain them for their affiliates or chapters, and there are plans for firms in particular industries, such as rural telephone companies and community banks. A multiple employer plan may be a defined benefit plan or a defined contribution plan. Some policymakers would like to give multiple employer plans that are defined contribution plans ("MEPs") a much larger role.

Last year, a presidential executive order directed the Department of Labor ("DOL") to "clarify and expand the circumstances under which United States employers, especially small and mid-sized businesses, may sponsor or adopt a MEP as a workplace retirement option for their employees, subject to appropriate safeguards" and also directed the Internal Revenue Service ("IRS") to review the qualification requirements for MEPs. Two recent regulatory actions resulted:

- The DOL published final regulations regarding the sponsorship of MEPs by employer associations and professional employer organizations ("PEOs").
- The IRS proposed to relieve MEPs from the so-called "unified plan" – or "one bad apple" – rule, under which a single participating employer's violation of the Internal Revenue Code's qualification requirements[3] would result in disqualification of the entire plan.

Meanwhile, Congress is considering legislation (passed by the House in May and pending in the Senate) that would go beyond the DOL rules by authorizing "open" or "pooled" MEPs that could be established by financial services firms and enroll any employer that wished to join.

The MEPs that the Congressional initiatives contemplate would be limited to defined contribution plans (also called individual account plans), which would include the familiar 401(k) variety, potentially with matching and/or nonelective employer contributions.[4] Thanks to economies of scale, combining many employers into a single plan offers the potential to lower recordkeeping and other administrative costs, as well as to improve investment returns by investing a larger pool of assets with more professional management. Larger plans also have readier access to other professional expertise and therefore are presumably better able to avoid legal and operational pitfalls. When problems do arise, the MEP sponsor would ordinarily be in a better position to address them than an individual employer would be.

The remainder of this article describes the DOL, IRS, and Congressional efforts in greater detail.

The DOL has More Clearly Defined Which Employer Associations and PEOs are Able Under Current Law to Sponsor Multiple Employer Plans

The advantages of a plan's status as a multiple employer plan depend to a large extent on the fact that it is a "single plan" rather than an "aggregation" of separate employers' plans, each of which must comply individually with ERISA and the Internal Revenue Code. For example, a multiple employer plan with 100 participating employers would file only one Form 5500 annual report, whereas 100 aggregated plans would have to file 100. Pooling investments is also more complicated for an aggregation of plans, necessitating the use of an entity known as a "Revenue Ruling 81-100 group trust," which is subject to its own set of special rules.

The DOL recognizes a plan covering unrelated employers as a single plan (a MEP) if, and only if, the entity that maintains it is an "employer," a term that ERISA defines somewhat ambiguously. Section 3(5) of ERISA states:

> The term "employer" means any person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan; and includes a group or association of employers acting for an employer in such capacity.

This definition is the touchstone for distinguishing a multiple employer plan from an aggregation of plans. If the plan is maintained by a bona fide employer association or by an entity that "acts indirectly in the interest of" the participating employers with respect to the plan, it is a MEP. If the "association" is not bona fide or if the entity purportedly acting in the employers' interest has no real connection with their employees, it is a bundle of separate plans.

DOL and other guidance on these distinctions was scanty until the Department published, on July 31, 2019, a final regulation[5] defining "employer." The scope of the regulation is limited to defined contribution plans maintained by employer associations and PEOs, omitting other possible MEPs (such as those established by related employers that do not form a controlled group). The new regulation is more liberal than previous guidance, so that some arrangements that would formerly have been treated as aggregations of plans will now be able to qualify as MEPs.

Employer Associations

The new regulation lays down these criteria for a bona fide employer association:

- The association must have a "substantial business purpose" other than providing employee benefits to its members (though benefits may be its primary purpose). "Substantial business purpose" is not defined but, "as a safe harbor, . . . is considered to exist if the group or association would be a viable entity in the absence of sponsoring an employee benefit plan." Included in "business purpose" are "promoting common business interests of its members or the common economic interests in a given trade or employer community." The purpose need not be for-profit.
- The association must be controlled by its members, and the plan must be controlled by the employers whose employees it covers.
- Each participating employer must employ at least one plan participant. That participant may be a business owner who regularly works at least in the business. Alternatively, an owner who also participates in a health plan sponsored by the association may qualify for participation in the MEP by earning at least enough from the business to pay the cost of health plan coverage.
- Participation in the plan must be open only to employees or former employees of association members.
- All participating employers must have "commonality of interests." This condition can be satisfied if they are either "in the same trade, industry, line of business, or profession" *or* have their principal places of business within the same state or metropolitan area. In its past, rather scanty guidance, the DOL had not recognized geography as a basis for meeting the commonality requirement.

The regulation does not allow sponsorship of MEPs by banks, insurance companies, broker-dealers, recordkeepers, third-party administrators, or other financial services firms, or by their subsidiaries or affiliates. The regulation thus stops well short of the "open MEPs" desired by many MEP proponents. The DOL concluded ERISA does not allow it to go that far. The preamble to the regulation made a point of observing that Congress can change ERISA. See the discussion below of the proposed SECURE Act, which would allow such institutions to sponsor MEPs.

Cautionary Note

The MEP regulation's definition of "association" is virtually identical to the one the DOL promulgated for "association health plans," a type of plan that is permitted to offer less extensive benefits than those generally mandated by the Affordable Care Act. Last March, a federal district court held that those regulations went beyond what ERISA allows.[6] The government is appealing that ruling. While the case involved issues other than the ERISA definition of "employer," three of the court's holdings could, if upheld on appeal, undermine the new MEP regulation.

- The court held that the regulation's requirement that associations have a "substantial business purpose" in addition to providing employee benefits was designed to be ineffectual and that no group of employers, no matter how tenuous their common interests, would be precluded from establishing an association health plan.
- The court also held that geographical contiguity was an insufficient basis for commonality, basing its argument primarily on the inconsistency between the regulation and informal guidance that the DOL had issued in the past.
- Finally, the court held that a plan in which sole proprietors without employees participate cannot be an ERISA-covered plan, even if other participating employers have employees.

The preamble to the MEP regulation does not discuss the court's conclusions. If the decision is upheld on appeal, it could lead to reconsideration of the criteria for MEP "employer" status, though it is possible that the ultimate outcome turn on unrelated is of the ACA litigation will turn on unrelated issues.

Professional Employer Organizations

Professional employer organizations lease workers to client organizations and relieve the clients of such burdens as paying wages, withholding taxes, and otherwise complying with tax and employment law requirements. Among other services, PEOs and other types of entities that offer employer services typically provide some form of retirement plan coverage for the employees. These plans may be, and usually are, multiple employer individual account plans. The MEP regulation addresses the circumstances under which the PEO will be considered to be acting in the interests of the participating employers in relation to the plan and thus be itself classified as an "employer." According to the regulation, a bona fide PEO must:

- Perform substantial employment functions for the participating employers;
- Be the plan sponsor, the plan administrator and a named fiduciary of the plan; and
- Continue to have benefit plan responsibilities toward participants after their employer ceases to be a client of the PEO.

Participation in the plan must be limited to individuals who were employees of a PEO client during the term of its contract with the PEO. Working owners with no employees may not participate in PEO-sponsored MEPs, a difference from the rules for association plans. (It is, of course, unlikely that a sole proprietor would have any use for a PEO's employment functions.)

Whether a PEO performs "substantial employment functions" for its clients is based on "facts and circumstances." The regulation provides a "safe harbor" list of functions that qualify, which include those typically assumed by PEOs.

The IRS Proposes to Revise the "One Bad Apple" Rule

As previously noted, a multiple employer plan may, in principle, be disqualified if *any* participating employer fails to comply with *any* plan qualification requirement. There is, in fact, no record that the IRS has ever thrown out a MEP barrel that was found to contain one wormy fruit, but the rule has some practical consequences.

Qualification failures, except for some egregious violations, can be corrected through the IRS's Employee Plans Compliance Resolution System ("EPCRS").[7] In some instances, correction requires the payment of a monetary sanction based on the size of the plan, the significance of the error, and the timeliness of the correction. In seeking relief under EPCRS, a plan sponsor currently is not formally able to base sanctions on the erring employer's share of the plan; instead, the calculation looks at the plan as a whole. Redirecting the gaze to the "bad apple" alone could be an improvement.

The IRS's proposed regulation, published on July 3, 2019, would formalize "the unified plan rule" (a more bureaucratic moniker than "one bad apple") and at the same time set forth a mechanism for avoiding its application. A plan administrator that knew or had reason to believe that a participating employer had not complied with qualification requirements would be obliged to give notice to the employer. Three courses of action would then be possible:

- The employer could take action to correct the defect.
- The employer could request that its portion of plan assets and liabilities be spun off into a separate single employer plan. It would thereafter be solely responsible for taking corrective action.
- If the employer did neither of the preceding, the plan administrator could unilaterally spin off the noncomplying portion of the plan into a separate plan, terminate it, and distribute its assets to participants. Despite the qualification failure, participants would be able to roll over their distributions tax-free to IRAs or other eligible rollover plans, though the IRS could (and probably would) take action, such as denying rollover treatment, with respect to participants whom it deemed responsible for the qualification failure.

These steps would require notices by the MEP to the employer and sometimes to its participants. The regulation is only a proposal and does not provide relief to defined benefit pension plans. Employers may not rely on it until it is adopted in final form. The due date for comments on the proposal was October 1, 2019. It is unlikely to go into effect until sometime in 2020, at the earliest.

Congress Moves Forward With "Open MEP" Legislation

Last May, the House of Representatives passed, by a vote of 417 to 3, the Setting Every Community Up for Retirement Enhancement Act of 2019 (H.R. 1994), a title that yields "SECURE Act."

If adopted in the form approved by the House, the SECURE Act would allow unrelated employers to participate in multiple employer plans (not including defined benefit plans) without any restrictions as to industry, geography, or any other factor. A plan would have to be administered by a "pooled plan provider" registered with the Treasury Department. The provider would be responsible for the selection of investment providers and any other duties specified by IRS regulations. The expectation is that providers would include financial institutions (that is, the kind of entities that cannot sponsor MEPs under the DOL regulation). The DOL would be required to publish a model plan document, though its use would not be mandatory. Providers and employers would presumably be entitled to rely on the model plan in a manner similar to reliance on IRS pre-approved master, prototype, and volume submitter plans.

The SECURE Act would be effective for plan years beginning on or after January 1, 2021. Pending the issuance of regulations, plans would be permitted to rely on a good faith interpretation of the statute.

The Senate Finance Committee approved a bill similar to the SECURE Act in 2018, including the authorization of open MEPs. The same Senate bill was reintroduced in 2019, sponsored by the chairman and ranking member of the committee. There are, however, some significant non-MEP differences between the SECURE Act and the Senate bill,[8] so, although the open MEP concept is not especially controversial, enactment in the immediate future is far from certain.

Notes

1. For a summary of state activity, see National Conference of State Legislatures, "State-Facilitated Retirement Savings Programs for Private Sector Workers," *http://www.ncsl.org/research/fiscal-policy/state-facilitated-retirement-savings-programs-for-private-sector-workers.aspx*.
2. *See Sara Lee Corporation v. American Bakers Association Retirement Plan*, 672 F. Supp. 2d 88 (D. D.C., 2009), which arose because government regulators had trouble telling multiple employer plans and aggregations apart.
3. Examples might include an employer's failure to satisfy the nondiscrimination requirements regarding coverage or benefits for its employees covered by the plan or improper exclusion of a particular employer's employees who satisfied the plan's eligibility conditions.
4. Multiple employer defined benefit plans exist. Several major tax-exempt organizations maintain them for their chapters. In the for-profit section, the Pentegra Defined Benefit Plan for Financial Institutions has a history going back to 1943. Two recent cases involving multiple employer defined benefit plans (one for Girl Scout chapters, the other for rural telephone companies) illustrate the problems that can arise in allocating the funding obligations among unrelated employers. *Girl Scouts of Middle Tennessee, Inc. v. Girl Scouts of the U.S.A.*, 770 F.3d 414 (6th Cir., 2014), *cert. dismissed*, 136 S. Ct. 29 (2015); *Townes Telecommunications, Inc. v. National Telecommunications Cooperative Association*, 2019 U.S. Dist. LEXIS 114243 (E.D. Va., July 9, 2019). Multiple employer defined benefit plans are also sometimes maintained during a transitional period after a corporate spinoff or are created for a joint venture with pooled employees. It is unlikely that liberalized rules would make multiple employer defined benefit plans attractive to small employers, and the MEP initiatives discussed here have omitted them for that reason.
5. 29 C.F.R., §2510.3-55.
6. *New York v. United States Department of Labor*, 363 F. Supp. 3d 109 (D. D.C., March 28, 2019).
7. Rev. Proc. 2019-19, 2019-19 I.R.B. 1086.
8. Two differences are of particular importance. (1) The House bill would raise the required beginning date for plan and IRA distributions from age 70½ to age 72, while the Senate bill would make no change. (2) To offset revenue losses from various liberalizations of current law, the House bill would shorten to 10 years the period over which beneficiaries of a plan or IRA may receive distributions, with exceptions for surviving spouses, minor children, and disabled beneficiaries. The Senate bill would reduce the period to five years, with similar exceptions, but would retain the current rules for the first $400,000 (indexed) of each beneficiary's interest. The bills also differ on 401(k) coverage for part-time employees, in-service withdrawals for childbirth and adoption expenses, credit card-like methods of obtaining plan loans, and some other provisions.

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