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MULTIPLE EMPLOYER PLANS

The Progress and Future of PEP Construction and Regulation

This column identifies and explains the key regulatory issues relating to group retirement programs and how they will shape the future of the industry.

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The pandemic has delayed construction of pooled employer plans (PEPs) by at least a few months, but the building continues, as do the efforts of the Executive branch to publish anticipated guidance about compensation, conflicts of interest, registration of pooled plan providers (PPPs), spinoffs of "bad apple" employers, and other topics of interest to the builders of PEPs and other multiple employer plans (MEPs). This column identifies and explains the key regulatory issues and how they will shape the future of the industry.

Knowledge Gaps

Despite extensive media and industry coverage of the subject, large gaps persist in the industry's understanding of MEPs, of which PEPs are a sub-type, and other types of group retirement programs. This discussion is divided into two parts: (1) background on types

of group retirement structures, and (2) a discussion of the shape of future regulation.

An Overview of the Group Retirement Marketplace

The following summary draws heavily on the letter from the American Retirement Association (ARA) to the Department of Labor (DOL) on the Department's request for information on "Prohibited Transactions involving Pooled Employer Plans under the SECURE Act and Other Multiple Employer Plans" (PEP RFI), to which the author was a primary contributor. The ARA letter should be available at *dol.gov* by the time of publication.

Types of Group Structure

Here is an abbreviated list of group structure types (abbreviations are explained below):

- MEPs, including
  - Association Retirement Plans (ARPs), including
    - Association plans
    - PEO plans
  - Non-ARP MEPs, including
    - "Corporate" MEPs
    - Section 413(c) plans that are not single ERISA plans
  - PEPs
- Group Trusts
- "Aggregation" arrangements
- "Groups of Plans" (GoPs)
- Endorsement arrangements.

Each structure is discussed briefly below.

Multiple Employer Plans

MEPs are mentioned in both the Employee Retirement Income Security Act of 1974, as amended, (ERISA) Section 210 and the Internal Revenue Code of 1986, as amended, (Code) Section 413(c), but because MEPs predate both statutes, the terminology used to describe them and the statutory and regulatory provisions regarding them are quite different between the two bodies of law. A number of MEP structures have arisen over the years, including:

1. **Association Retirement Plans**. MEPs that meet the 2019 final regulation requirements [Labor Reg. § 2510.3-55] to be considered single ERISA plans. There are two general categories of ARPs:
   a. **Bona fide group or association of employers** (association plans for purposes of this response). These plans can include, for example, sponsorship by not-for-profit associations, groups of employers in the same trade or line of business, employers in a particular city or state, and chambers of commerce.
   b. **Bona fide professional employer organizations** (PEO plans). These plans are limited to sponsorship by organizations that meet the "bona fide PEO" definition. It is useful to mention types of organization that are similar to PEOs but do not meet the definition of "bona fide PEO," such as payroll companies, human resources (HR) consultancies, HR outsourcing firms, or PEO firms acting in an "administrative services only" (ASO) capacity. Such firms would benefit from sponsorship of a MEP for their clients but cannot do so under the bona fide PEO plan structure; they can do so with a PEP.
2. **Other MEPs that Are Not ARPs** (Non-ARP MEPs). The 2019 ARP final rule leaves a possible gap in coverage of MEPs in that the rule supersedes previous guidance, yet does not cover the most common type of MEP—the "corporate" MEP.
   a. **"Corporate" MEPs**. The preamble to the October 2018 proposed ARP regulations used the term "corporate" MEP to describe a MEP whose adopting employers are part a group of employers that are all related, but not to the extent that they would be treated as a single plan under the controlled group or affiliated service group rules. Corporate MEPs are the most common type of MEP in the United States, by a wide margin. Well-known corporate MEPs include the plans of General Electric, Siemens, and Yum Brands. Such plans are, in most respects, similar to large single employer plans and not similar to association plans, PEO plans, PEPs, or other non-ARP MEPs.
   b. **Code Section 413(c) Plans That Are Not Single ERISA Plans** (the old "open" MEPs). A plan operated under a single document which meets the definition of a "section 413(c) plan" under the Code is a MEP for Code purposes but not necessarily a single plan for ERISA purposes. A Section 413(c) plan treated as a collection of single employer plans for ERISA purposes could be called an "open" MEP. Such plans exist today

and may continue to exist for some time. They are identical to other MEPs in most respects. Some such plans will likely convert to PEPs.

3. **Pooled Employer Plans**. A Section 413(c) plan that has a Pooled Plan Provider as described in Code Section 413(e). PEPs are a subtype of MEPs.

Group Trusts

Group trusts can take various forms and are treated differently under the various statutory and regulatory regimes in the United States (labor, tax, banking, and securities law). Terminology around these structures is confusing. Labor law uses terms such as "master trust" and "common or collective trust." "Group trust" is a tax law term, while securities law refers to collective investment funds (CIFs), which the industry has taken to calling (somewhat incorrectly), CITs or collective investment trusts.

The use of a group trust structure to create a group retirement program is a specific application of a general structure, and there are few of them. There is a handful of decades-old programs in existence and another handful of new ones. Some such trusts may wish to convert to or participate in PEPs or other MEPs. Others may wish to restructure to take advantage of the new "group of plans" or "GoP" structure under Section 202 of the SECURE Act (see below).

"Aggregation" Arrangements

In the wake of the DOL's publication of advisory opinions 2012-03A and 2012-04A, multiple structures arose in the marketplace in imitation of open MEPs. New group trusts were one such structure, but new terms such as "aggregation arrangement," "exchange," "multiple employer program," and others arose as terms to describe marketing bundles for single employer plans that had features, such as the same investment manager, fund lineup, and recordkeeping platform. Some programs included a trustee and/or a professional ERISA Section 3(16) plan administrator for all participating employers, and others included these services as options. Some of these programs are logical candidates to convert to PEPs or GoPs.

Groups of Plans

GoPs were created under SECURE as an alternative to PEPs and other MEPs. The origin of this provision was a perception that the difference between MEPs and single employer plans was the ability to submit a combined Form 5500 with a single audit. If this were the only significant difference between MEPs and aggregation arrangements, then a combined 5500 would create a MEP-like structure without any fuss. As GoPs are evolving today in the marketplace, they are a PEP alternative that allows service providers to imitate many PEP benefits but accept less fiduciary risk and responsibility than in a PEP.

Association Member Service Offerings

A service common to not-for-profit organizations is to offer a range of products and services to its members, often at discounted prices or with special features and benefits. Such arrangements may not involve an explicit endorsement by the association, but are sometimes referred to as "endorsement arrangements." Associations often have robust member services departments focused on delivering highly competitive, high quality products and services to members. The association typically receives compensation for such products and services.

Sponsorship Structures and Approval of Compensation and Services

A large percentage of the confusion surrounding MEPs historically has been around the basic sponsorship and governance structure. In other words, who is permitted to sponsor a MEP, and who is permitted to get paid, and how?

Historically, there have been several possible sponsorship structures for MEPs, and such structures are still pertinent today. SECURE adds a new sponsorship structure—the PPP. Sponsorship structures and the source for independent fiduciary approval of services and compensation for fiduciaries [as required by Labor Reg. § 2550.408b-2(e)] are key elements of the discussion of possible prohibited transactions.

MEPs have significant differences from single employer plans. For purposes of potential prohibited transactions, one of the most important differences is that many MEPs are sponsored by not-for-profit groups or associations that provide such services for members, and may be compensated by members to make the service possible. PEPs, similarly, are sponsored by service providers who receive compensation.

Contrast this with the typical single employer plan, which is sponsored by a company for its own employees—and no one else's—and for which the employer does not require or seek compensation. When an entity sponsors a plan for employees other than its own, compensation is generally required—and

the need to have that compensation approved by an independent fiduciary is at the heart of the PEP prohibited transaction discussion.

The "independent fiduciary requirement" comes from Labor Regulations Section 2550.408b-2 (the 408(b)(2) regulations). The basic structure of ERISA is that providing services and receiving compensation of any kind in an ERISA plan is prohibited [ERISA § 406] and becomes possible only under one or more prohibited transaction exemptions (PTEs). The principal PTE for providing services for compensation is the statutory exemption under ERISA Section 408(b)(2), and the corresponding 408(b)(2) regulations provide three general requirements to qualify for exemption: the service must be necessary, the compensation must be reasonable, and there must be a reasonable contract or arrangement in place that includes specified disclosures.

The 408(b)(2) regulations also specify additional conditions when the service provider is a fiduciary: any compensation, whether direct or indirect, must be approved by an "independent fiduciary." A fiduciary is independent for this purpose when she has no interest in the transaction that might impair her best judgment as a fiduciary [Labor Reg. § 2550.408b-2(e)].

In a typical single employer plan, the employer is the plan sponsor and a plan fiduciary, and does not receive compensation, direct or indirect, for these services. But in a MEP or PEP sponsored by an entity on behalf of the employees of other employers, the entity typically needs compensation in order to provide the service—thus the need for independent fiduciary approval. The need to find a "clean" or unconflicted source for this approval is, therefore, at the heart of any discussion of MEP sponsorship and governance structures.

Possible MEP Sponsorship Structures

1. **Lead employer.** In a corporate MEP, there is typically one employer who takes the lead in sponsoring the plan, which "related" employers can adopt. The employers are unrelated for purposes of the controlled group and affiliated service group rules under the Code, but typically have some common ownership and are thus "related" in the ordinary sense of the term.
2. **Association sponsor.** A not-for-profit organization sponsors and controls the plan.
3. **Board sponsor.** A board of directors or plan committee whose voting members consist solely of participating employers' sponsors and controls the plan on behalf of all participating employers, who may be described as "co-sponsors." Examples:
   a. A trade group ARP sponsored by a board of directors whose voting members consist solely of the plan's participating employers.
   b. A 403(b) ARP co-sponsored by a group of 501(c)(3) organizations who are all members of the same 501(c)(6) association. Because the 501(c)(6) organization is not eligible under the Code to participate in or sponsor a 403(b), a plan committee or board represents all participating employers in sponsoring the plan.
4. **PEO sponsor.** A professional employer organization sponsors the plan on behalf of recipient employers.

Methods for Independent Fiduciary Approval of Services and Compensation of Fiduciaries and Other Service Providers

The following structures are possible methods for satisfying the requirement that an independent fiduciary approve services and compensation of fiduciaries and service providers as required under 29 CFR 2550-408b-2.

1. **Board or committee approval.** A board or committee consisting solely of participating employers can serve as the independent fiduciary for purposes of approving compensation of fiduciaries and/or service providers. The board members themselves receive no compensation from plan assets. Examples:
   a. In a trade group MEP sponsored by a board of directors, the board appoints fiduciaries and service providers and approves their compensation.
   b. In an ARP sponsored by an association, a committee consisting solely of participating employers serves as an independent fiduciary for the purpose of approving compensation for the association for services rendered.
   c. In an association-sponsored 403(b) ARP, a plan committee consisting solely of participating employers approves compensation for services provided by the association.
2. **Independent fiduciary approval.** A third-party independent fiduciary can be engaged to approve services and compensation. One of the challenges for using a third party is that the revenue that party derives from the plan should not be so

great as to create a potential conflict of interest. For example, if an independent fiduciary serves a MEP that grows substantially, such that the fiduciary's compensation for the plan becomes 50 percent of the fiduciary's total revenue, it could be argued that the extent of the revenue impairs the fiduciary's best judgment and renders her non-independent or conflicted. The DOL has historically looked for very low revenue percentages in these arrangements; for example, 5 percent in the SunAmerica Letter [DOL Advisory Opinion 2001-09A] and just 2 percent in the 2016 definition of "fiduciary" regulation [Labor Reg. § 2510.3-21, since overturned, but nonetheless indicative of the Department's views of what constitutes "independence"].

3. **Approval by participating employers.** ERISA Section 3(43)(B), as established by SECURE Act Section 101(c)(1), requires that a PEP's plan terms "provide that each employer in the plan 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." Historically, the Department has not viewed approval by participating employers, in and of itself, as sufficient for the purposes of meeting the requirements of Labor Reg. Section 2550.408b-2(e) (independent fiduciary approval) [*see, e.g.*, Advisory Opinion 2012-04A], but SECURE makes such an approach the statutory norm for PEPs (but only for PEPs—not for other MEPs). How the DOL chooses to interpret this new statutory language is important.

One possible interpretation is that the ability of adopting employers to choose to join or leave a PEP—that is, their ability to "vote with their feet" by choosing to join, stay in, or leave a MEP—constitutes approval of services and fees by independent fiduciaries. Another possible interpretation is such ability does not constitute sufficient control of the plan by adopting employers; this approach is closer to the DOL's historic position on the issue. [*See* Advisory Opinion 2012-04A] But the new statutory language clearly places responsibility for selection and monitoring of the PPP on the shoulders of participating employers, so the question is whether the DOL will seek to impose an "independent fiduciary" requirement that goes beyond "voting with your feet." For example, a regulation might require oversight by a third-party fiduciary or plan committee who reports to participating employers on the reasonableness of the PPP's services and fees. Or the DOL may ultimately regulate or enforce what it considers to be "independent" through its authority to regulate PPPs.

The DOL's interpretation of the SECURE Act Section 101(c)(1) provision that individual participating employers are responsible for selecting and monitoring the PPP is a critical element that will determine the future of PEP supervision and enforcement. The statutory language seems to indicate that employers have sufficient control over PPP services and fees by virtue of being able to enter and leave the PEP—"voting with their feet"—and that no additional approvals or oversight are necessary. Whether the DOL agrees with that notion is the key issue.

Compensation in Group Retirement Arrangements

The Fundamental Conflict in MEPs for Which Clarification Is Needed: Compensation of the Plan Sponsor

In a single employer plan, plan sponsors generally are prohibited from receiving compensation. ERISA Section 405(c) states that ERISA's prohibited transaction rules shall not be construed "…to prohibit any fiduciary from…receiving any reasonable compensation for services rendered…except that no person so serving who already receives full time pay from an employer or an association of employers, whose employees are participants in the plan, or from an employee organization whose members are participants in such plan shall receive compensation from such plan, except for reimbursement of expenses properly and actually incurred." The Department historically has interpreted Section 408(c) as prohibiting plan sponsor compensation other than reimbursement of expenses.

Enabling service providers to accept the PPP role and become plan sponsors of open MEPs is the point of SECURE Act Section 101, but the PPP must be compensated for PEPs to exist. One of the key questions on the minds of potential MEP or PEP service providers and PPPs is: Under what circumstances can I receive compensation?

Is SECURE's statutory language alone sufficient to clarify that PPPs can be compensated, and that no additional independent fiduciary approvals are needed? Will the DOL issue new PTEs or rewrite existing ones to provide clarity to MEP sponsors and fiduciaries? These are the questions for which PEP builders are awaiting guidance.

The Proposed Investment Advice PTE

Section I(c)(1)(A) of the proposed PTE for Improving Investment Advice for Workers & Retirees states that the exemption is not available if the Investment Professional, Financial Institution, or any affiliate is the employer of employees covered by the Plan or a named fiduciary or plan administrator that was selected by a party that is not independent. This language could be construed as prohibiting PPPs and other named fiduciaries of PEPs and MEPs from receiving compensation with respect to investment advice, which will be a primary offering of many potential MEP or PEP service providers. Adjustments to the advice PTE may, therefore, be issued in combination with any guidance the Department issues with respect to MEPs and PEPs.

Compensation for Not-for-Profit Associations

Associations typically conduct non-fiduciary due diligence on various products and services on behalf of members, and the members view such assistance as one of the reasons for joining the association. The association expends resources on these programs, for which it needs to be compensated. There are four principal methods of compensation:

1. **Licensing Agreements.** The product or service provider pays a licensing fee from its own assets to the association in exchange for the right to use the association's marks in marketing the benefit to association members.
2. **Commission or Fee Sharing.** The association is paid a portion of service provider revenues in the form of a commission, finder's fee, or other payment tied to product distribution.
3. **Sponsorship Payments.** Service providers pay to attend association conferences or receive other marketing access to members.
4. **Fee-for-Service.** The association provides services for compensation. Examples of services include educating members about the product or service and its benefits, serving as a liaison with service providers, providing logistical support for board or committee meetings, and assisting with due diligence. In some cases, the association is the direct provider of a service.

Vertical Integration of Service Providers

Many service providers receive compensation from a variety of sources. In general, they strive to act as non-fiduciaries to the extent possible because of the complexities of compensation under ERISA. For example, a broker-dealer that is also a recordkeeper and an asset manager may receive revenues from float, trading, asset management, direct fees, revenue sharing from other asset managers, and more. In such cases, the broker-dealer typically would limit its fiduciary duties to a very narrow scope, and act as a non-fiduciary for all other purposes.

There are pros and cons to such arrangements. The pros include the potential for reduced costs and the "one-stop shop" experience for employers and participants. The primary con is that the arrangement involves multiple potential conflicts of interest.

As a practical matter, vertically integrated service providers cannot easily embrace broad fiduciary status under today's regulatory regime. There are arguments for maintaining that status quo. But there also are plausible arguments for encouraging the vendor community to embrace fiduciary status by granting exemptions that permit integrated models and the use of affiliates, but with appropriate transparency and protections for participants and beneficiaries. Vertically integrated service providers are, therefore, especially interested in how the DOL responds to the question of MEP and PEP regulation, and whether the regulatory "package" that results provides sufficient clarity to allow the use of affiliates and proprietary products.

One critical element of the regulatory picture is SECURE's enactment of the new ERISA Section 3(43) definition of "pooled employer plan," which includes the stipulation that the plan's terms must require that participating employers retain fiduciary responsibility for two things:

1. Selection and monitoring of the PPP and other named fiduciaries, as discussed previously.
2. "…to the extent not otherwise delegated to another fiduciary by the pooled plan provider and subject to the provisions of section 404(c), the investment and management of the portion of the

plan's assets attributable to the employees of the employer (or beneficiaries of such employees)." [ERISA Section 3(43)(B)(iii)(II)]

This second provision provides a path that could allow providers to include proprietary investment products using individual employer choice (a variant on the "voting with your feet" discussion) as the mechanism for satisfying the independent fiduciary requirement.

The Regulatory Future

The Fishbowl Effect

It is hard to see what the fish are up to in a muddy pond, but not in a tiny fishbowl. PEPs and other MEPs are a mechanism whereby a service provider's block of business is tidily assembled in one place for easy scrutiny by regulators and the plaintiffs' bar. The stakes and expectations are raised and margin of error lowered, even though everyone expects prices to go down, when logically, they should probably go up. The financial industry already is living in a regulatory fishbowl, but PEPs and other MEPs can expect the "fishbowl effect" to be especially strong.

The Regulatory Trend Is "Up"

The longstanding trend in the United States is toward greater transparency and mitigation of conflicts of interest. In the early 2000s, the late day trading and market timing scandals in the mutual fund industry triggered a series of events that influenced the DOL to issue its series of three transparency initiatives starting in 2007: new disclosures on the Form 5500 Schedules A and C, participant disclosures under Labor Reg. Section 2550.405a, and fiduciary disclosures under the 408(b)(2) regulations. These transparency initiatives were followed by a redefinition of "fiduciary" [proposed Labor Reg. § 2510.2-21 in 2010, which was subsequently withdrawn under pressure from Congress and industry groups] and the DOL's 2016 conflict of interest package (which was overturned in 2018). But the fact that the DOL's fiduciary package was overturned does not mean that the debate has ended.

Conflicts of interest are inherent to nearly every endeavor of living beings. Every seller, for example, has a conflict of interest with respect to every buyer. Doctors often have enormous conflicts of interest—they are paid a lot for surgery but very little for telling people not to have surgery—but, by and large, people trust doctors. The rhetoric around financial services seems increasingly tilted toward the "ERISA-fication" of conflicts of interest, whereby ERISA's "all is prohibited unless an exemption applies" prohibited transaction rules are the baseline. The ERISA approach contrasts sharply with that of the common law of trusts, under which "disclosure and consent" is the basic model—that is, conflicts of interest are permitted as long as a provider makes appropriate disclosures and the client offers informed consent of the arrangement.

The implication is that PPPs hope for very clear guidance, probably in the form of prohibited transaction exemptions, on how they can do things like use affiliates to provide investment or recordkeeping services and use proprietary investment products in their PEPs.

How the DOL Might Respond to Calls for Guidance

The expectation among retirement industry members for many years—back before SECURE became law—has been that the DOL would need to issue a new package of guidance in the wake of the creation of PEPs. The expectation, further, is that such a package would be forthcoming, and that it would include new PTEs and/or clarification with respect to the applicability of existing ones.

In contrast, the response letter from Congressman Richard Neal (D-Massachusetts), Chairman of the House Ways and Means Committee, to the DOL with respect to the PEP RFI offers perspective on how some in Washington view the question of new prohibited transaction exemptions to permit the use of proprietary products or subsidiaries. Chairman Neal's letter says, "In my view, any conflicts of interest would be entirely inconsistent with congressional intent. Congressional intent with respect to this provision [*i.e.*, PEPs] is that the pooled plan provider should not be the fiduciary responsible for overseeing itself as the provider of investment products and services to the plan. No financial institution should be overseeing itself." Further, "the suggestion that conflicts of interest be permitted was proposed to Congress on many occasions. This idea was repeatedly rejected as is clear in the statutory language enacted." [The response letter from Chairman Neal should be available at dol.gov in connection with the PEP RFI by the time of publication]

This is a clearly worded letter, and it highlights the importance of getting clear guidance from the

DOL with respect to the prohibited transaction questions described above. ERISA prohibits everything, and PTEs are the only way to get anything done. Everything is characterized as a conflict of interest under ERISA, including things that are not viewed as conflicts of interest (for example, providing services and receiving compensation) under other laws and regulations, such as securities or banking laws. The term "conflicts of interest" elicits a gut response of, "That's bad," yet ERISA's basic nature is that it calls *everything* "bad" and only permits even ordinary services through PTEs.

The author believes that, ultimately, the DOL will clarify that industry service providers may offer PEPs and act as PEP or MEP fiduciaries and may use affiliates and proprietary products in these endeavors. After all, the overturned 2016 conflict of interest package provided rules that permitted precisely those arrangements, suggesting that the DOL is comfortable with such arrangements as long as appropriate protections are in place for plan participants and beneficiaries.

Conclusion

The future of MEP and PEP regulation hinges on a few key concepts:

- What are the steps a PPP must take to ensure it may be compensated?
- Does the collective action of employers choosing to participate in a PEP constitute approval by an independent fiduciary of a PPP's services and compensation, or are additional checks and balances necessary?
- Under what circumstances may PPPs use proprietary products or work in tandem with affiliates?
- The fishbowl effect: PEPs and other MEPs concentrate plan assets in a tidy bundle that is easily found and targeted by regulatory authorities and the plaintiffs' bar.

We have a template for how one extreme of such guidance might work: the 2016 DOL conflict of interest rules package. The 2016 "fiduciary rules" package raised substantial concerns within the retirement industry, but these rules offer a glimpse of what one extreme of DOL regulation of PEPs might look like.

At the other extreme, the new statutory language of SECURE Act Section 101 might be sufficient to cover the independent fiduciary requirement of Labor Reg. Section 2550.408b-2(e). Participating employers retain fiduciary responsibility for selecting and monitoring the PPP and plan investments, and if that responsibility fully answers the questions posed above, all that is needed from the DOL is clarification that this is so.

Regardless of the outcome, industry service providers are entering a new era, in which fiduciary responsibility—which they tended to avoid assiduously for decades—becomes the norm. Fiduciary competence, including competence with fiduciary administration, will be the lynchpin of future success for those of us living in the regulatory fishbowl. ■

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