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TOPIC: The DOL Finalizes Rules for Association Retirement Plans

MARKET TREND: On July 31, 2019, the Department of Labor (the "DOL") finalized a new regulation (the "Regulation")[1] clarifying and expanding on ways that smaller employers can band together to participate in defined contribution multiple employer plans (or "MEPs") – sometimes referred to by the DOL as "association retirement plans."[2] The DOL intends the Regulation to increase access to workplace retirement plans for many private-sector workers, including "working owners." The Regulation intentionally mirrors DOL regulations adopted last year authorizing "association health plans" that is currently blocked by the federal courts based on potential adverse impacts on the Affordable Care Act.[3]

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[1] *See* "Definition of 'Employer' Under Section 3(5) of ERISA-Association Retirement Plans and Other Multiple-Employer Plans" published in the Federal Register on July 31, 2019, available here: https://www.federalregister.gov/documents/2019/07/31/2019-16074/definition-of-employer-under-section-35-of-erisa-association-retirement-plans-and-other

[2] *See* "Fact Sheet: Final Rule on Association Retirement Plans (ARPs)" published by the DOL's Employee Benefits Security Administration, available here: https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/final-rule-on-association-retirement-plans

[3] *See State of New York v. United States Department of Labor*, 363 F. Supp. 3d 109 (District Court for the District of D.C., March 28, 2019).

SYNOPSIS: The Regulation, which becomes effective on September 30, 2019, clarifies the meaning of "employer" under the Employee Retirement Income Security Act of 1974 ("ERISA") to include both (i) a "bona fide" employer group or association ("Association") and (ii) a "bona fide" professional employer organization ("PEO"). The Regulation allows a bona fide Association or PEO to sponsor a defined contribution MEP that is treated as a single plan under ERISA, even though multiple contributing employers participate in it. Such "single plan" treatment under ERISA allows simplified compliance and administration of the MEP, presumably at reduced cost and risk to the contributing employers, while also allowing a larger asset base for negotiating better economic terms with plan vendors and lower expense ratios for plan investment funds. The Regulation provides guidance as to what constitutes a "bona fide" Association or PEO, specifying required conditions and in some cases including safe harbor criteria. The Regulation provides that an Association may be bona fide either by a representing a group of employers in a common industry or, importantly, a common geography (such as a state or a municipality). The Regulation clarifies that "working owners" with businesses that do not have common law employees may participate in bona fide Association-sponsored MEPs. The Regulation also provides greater certainty as to the status of PEOs as permitted MEP sponsors. The Regulation, however, does not apply to defined benefit retirement plans.

TAKEAWAYS: The Regulation should simplify the administrative burdens and costs for sponsoring and maintaining a defined contribution MEP for smaller employers bound together through a bona fide Association or PEO. Associations and PEOs that wish to sponsor a MEP will want to see if they qualify as a "bona fide" organization under the Regulation's standards. The DOL has also requested comments by the end of October on the possibility of "open MEPs" – which would be MEPs for unrelated groups of employers not bound by a common industry or geography and not receiving broader employment-related services as with a PEO.

The Need for Expanded Access to Retirement Plans

The DOL and the Trump Administration believe that private-sector workers at smaller employers do not have enough access to ERISA-covered retirement plans. As cited in the release accompanying the Regulation, 23% of all private-sector, full-time workers do not have access to a workplace retirement plan. This statistic includes 47% of workers at private-sector businesses with fewer than 100 workers that do not have access to a retirement plan. To the DOL, these statistics are concerning because "although there are ways to save for retirement outside of the workplace, none are as advantageous to workers as employment-based plans."[4] The DOL notes at least five advantages of an ERISA-covered retirement plan over non-ERISA alternatives such as IRAs:

- higher contribution limits;

[4] *See* "Definition of Employer" cited above at page 37508.

- generally lower investment management fees as the size of plan assets increases;
- a well-established uniform regulatory structure with important consumer protections, including fiduciary obligations, recordkeeping and disclosure requirements, legal accountability provisions, and spousal protections;
- automatic enrollment; and
- stronger protections from creditors.[5]

To address this need, on August 31, 2018, President Trump issued Executive Order 13847 on "Strengthening Retirement Security in America," which states that "[i]t shall be the policy of the Federal Government to expand access to workplace retirement plans for American workers."[6] The DOL responded with proposed regulations published on October 23, 2018 that were subject to an extended comment period. The final rules generally follow the rules as originally proposed.

The Definition of "Employer" Under ERISA

The Regulation encourages expanded access to workplace retirement plans by clarifying how groups of generally unrelated, smaller employers can band together in a single ERISA-covered plan sponsored by a third party.

The challenge to doing so derives from ERISA's requirement that a "plan" must be sponsored by an "employer." ERISA Section 3(5) defines an "employer as follows (emphasis added):

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

A MEP is a retirement plan sponsored by two or more unrelated employers. Unrelated in this sense means the employers sponsoring the MEP are not part of the same controlled group, which generally requires 80% common ownership (either parent/subsidiary or brother/sister). Absent a single "employer" acting as the plan sponsor, normally the MEP will be treated as a collection of individually sponsored plans that each have to separately comply with ERISA, including each having to file an annual Form 5500, obtain an annual plan audit (if applicable), obtain its own ERISA bond, have its own ERISA "plan administrator" and "plan fiduciary," etc. The compliance and administrative costs for meeting these requirements can deter adoption of a MEP by smaller employers.

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[5] *Id*. at page 37528.

[6] *See* "Executive Order on Strengthening Retirement Security in America" published by the White House on August 31, 2018, available here: https://www.whitehouse.gov/presidential-actions/executive-order-strengthening-retirement-security-america/

The ERISA definition contemplates that a "group or association of employers" may act as a single "employer" for this purpose. This phrase is not otherwise defined in ERISA or a related regulation. The DOL in prior guidance more narrowly construed the meaning of "group or association of employers" to require "sufficiently close economic or representational nexus to the employers and employees that participate in the plan that is unrelated to the provision of benefits." The prior DOL guidance also made it unclear whether most PEOs could meet this standard. Given these constraints and uncertainty, many employers, and especially small employers, refrained from participating in a MEP.

Bona Fide Associations and PEOs Under the Regulation

The Regulation applies a more expansive interpretation of "employer" than the DOL's prior guidance to permit two new types of entities to sponsor a MEP treated as a single ERISA plan: (1) a bona fide Association, and (2) a bona fide PEO. The Regulation especially relies on the language in the ERISA statutory definition regarding a person acting "indirectly in the interest of an employer" and the reference to a "group or association of employers acting for an employer."

For a plan sponsored by a bona fide Association or PEO, various ERISA requirements can be satisfied by the Association or PEO rather than separately by each participating employer, including the filing of a single Form 5500 and conducting one plan audit. The Association or PEO can act as the ERISA-required "plan administrator" and serve as the "plan fiduciary." In this manner, the participating employers can lower compliance costs and risks. And the Association or PEO can use the larger pool of plan assets to obtain economies of scale, such as lower costs on plan expenses such as for third party administrators or investment fund fees. The participating employers still have some ERISA fiduciary duties, including to prudently select and monitor the Association or PEO, but the costs and risks associated with their participation in the Association's or PEO's plan should be lower than if they had to separately sponsor their own plan.

The Regulation details standards by which an Association or PEO can be considered a "bona fide" Association or PEO.

Requirements to be a Bona Fide Association. To constitute a bona fide Association, the Regulation imposes seven criteria that each must be satisfied:

1. Commonality of interests;

2. Substantial business purpose (apart from MEP sponsorship);

3. Employer member control;

4. Each employer member has at least one employee who is a participant;

5. Only current and former employees (and their beneficiaries) of employer members can participate;

6. The Association has a formal organizational structure; and

7. The Association is not a bank, trust company, insurance issuer, broker-dealer, or similar financial services firm.

As to the first requirement, the Regulation expands from prior DOL guidance to prescribe two ways to demonstrate a commonality of interest. An Association can either:

- share the same trade, industry, line of business or profession, or

- have a principal place of business in the same region, which cannot exceed the boundaries of a single state or metropolitan area (if the metropolitan area includes multiple states).

In particular, the addition of a geographic-based commonality of interest represents a significant expansion from prior DOL guidance.

As for how the DOL plans to determine what constitutes a trade, industry, etc., the DOL provides in the preamble to the Regulation that it plans to broadly interpret these terms in sticking with the Regulation's overall purpose – to expand employer and employee access to MEPs. Accordingly, "the [DOL] ordinarily will not challenge any reasonable and good faith industry classification or categorization." The DOL appears to believe that permitting commonality of interest based on geography may encourage Associations based on chambers of commerce and similar organizations.

As to the second requirement, regarding a "substantial business purpose" apart from MEP sponsorship, the DOL characterizes this as "not a lenient standard." According to the DOL, "a business purpose other than MEP sponsorship does not have to be the lifeline of the organization" but the other business purpose must be of "considerable importance." As a safe harbor to this criterion, the Regulation provides that a substantial business purpose will be deemed to exist if the Association would be a viable entity in the absence of sponsoring a MEP. The substantial business purpose does not have to be a for-profit activity.

Finally, as to the requirement that the functions and activities of the Association are controlled by its employer members, the Regulation does not require the Association's members to manage the day-to-day affairs of the Association. The Regulation provides the following non-exclusive factors that the DOL considers particularly relevant to this analysis:

- Whether employer members regularly nominate and elect directors, officers, trustees, or other similar persons that constitute the governing body or authority of the Association and plan;

- Whether employer members have the authority to remove any such director, officer, trustees, or other similar person with or without cause; and

- Whether employer members that participate in the plan have the authority and opportunity to approve or veto decisions or activities which relate to the formation, design, amendment, and termination of the plan.

Requirements to be a Bona Fide PEO. A PEO is a human-resource company that contractually assumes certain employer responsibilities of its client employers. The Regulation imposes four requirements for a PEO to be considered "bona fide":

1. The PEO performs "substantial employment functions" on behalf of its client employers that adopt the MEP, and maintains adequate records relating to such functions;

2. The PEO 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), and continues to have employee benefit plan obligations to MEP participants after the client employer no longer contracts with the PEO;

3. The PEO ensures that each client employer that adopts the MEP has at least one employee who is a participant under the MEP; and

4. The PEO ensures that participation in the MEP is available only to employees and former employees of the PEO and client employers (as well as employees and former employers of former client employers who became participants during the former client employer's contract period with the PEO).

These requirements are generally determined based on the facts and circumstances. But the Regulation also includes a safe harbor to determine whether the PEO provides "substantial employment functions." The DOL will deem the PEO to satisfy the "substantial employment functions" prong if the PEO does each of the following:

- Assumes responsibility for and pays wages to employees of its client-employers that adopt the MEP, without regard to the receipt or adequacy of payment from those client-employers;

- Assumes responsibility for and reports, withholds, and pays any applicable federal employment taxes for its client employers that adopt the MEP, without regard to the receipt or adequacy of payment from those client employers;

- Plays a definite and contractually specified role in recruiting, hiring, and firing workers of its client-employers that adopt the MEP, in addition to the client-employer's responsibility for recruiting, hiring, and firing workers or retains the right to recruit, hire, and fire workers of its client-employers that adopt the MEP; and

- Assumes responsibility for and has substantial control over the functions and activities of any employee benefits which the service contract may require the PEO to provide, without regard to the receipt or adequacy of payment from those client employers for such benefits.

Treatment of Working Owners

Consistent with the DOL's goal of expanding employer-provided retirement plans, the DOL recognizes in the Regulation that many Americans currently without a workplace retirement plan are sole proprietors and other self-employed individuals. To increase those individuals' access to a workplace retirement plan, the Regulation permits certain sole proprietors and other self-employed individuals that satisfy the Regulation's definition of a "working owner" to be treated as both a member employer and an employee for purposes of participating in a MEP sponsored by a bona fide Association, but not a bona fide PEO.

Under the Regulation, a "working owner" is a person who a responsible plan fiduciary reasonably determines is an individual:

1. Who has an ownership right of any nature in a trade or business, whether incorporated or unincorporated;

2. Who is earning wages or self-employment income from the trade or business for providing personal services to the trade or business; and

3. Who either:

    a. Works on average at least 20 hours per week or at least 80 hours per month providing personal services to the working owner's trade or business, or

    b. Has wages or self-employment income from his or her trade or business that at least equals the owner's cost of coverage for participation by the working owner and any covered beneficiaries in any group health plan sponsored by the Association in which the individual is participating or eligible to participate.

The DOL included the earned-income test because it believes it is a meaningful metric to ensure that the working owner has a legitimate trade or business and for administrative convenience. According to the Regulation, the DOL believes many bona fide Associations will offer both MEP and health plan coverage (under the association health plan rules, if they survive the courts). Since the Association would know a working owner's health coverage cost, it would not have to also track the working owner's hours.

Final Thoughts

Under the Regulation, a MEP offered by a bona fide Association or PEO will be subject to ERISA, including ERISA's fiduciary responsibility and prohibited transaction provisions. Operationally, these responsibilities generally fall on the MEP's sponsor (i.e., the Association or PEO) and not on the individual employers, but the individual employers retain fiduciary responsibility for monitoring their arrangement with the MEP's sponsor and forwarding the appropriate contributions to the sponsor. While the Regulation seeks to expand retirement plan access by generally lowering the entry barriers to qualified retirement plans for smaller employers, some of the Regulation's provisions are complex and require careful analysis against the specific facts. Also, MEPs are subject to separate Internal Revenue Code requirements applicable to tax-qualified retirement plans, including non-discrimination testing and service-counting requirements. Therefore, setting up a MEP in reliance on the Regulation will likely require the assistance of qualified ERISA counsel and other advisors.