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TOPIC: SECURE Act Expands Opportunities for "Open MEP" 401(k) Plans

MARKET TREND: The SECURE Act adds new rules that encourage the establishment of 401(k) plans covering multiple unrelated employers. These new rules may allow smaller employers to take advantage of economies of scale and offer 401(k) or other defined contribution retirement plans in a more cost-effective manner. The new rules become effective for plan years beginning after December 31, 2020.

SYNOPSIS: A "multiple employer plan" ("MEP") is a retirement plan offered by a single plan provider to the employees of multiple unrelated employers. Before the SECURE Act, MEPs were not broadly available to smaller employers. Recent Department of Labor ("DOL") proposed regulations would have permitted 401(k) and other defined contribution MEPs to be offered by certain employer associations or "professional employer organizations" ("PEOs"). The SECURE Act rules go beyond these DOL proposed regulations. The SECURE Act will permit 401(k) or other defined contribution MEPs sponsored by a "pooled plan provider" without any common interests among the participating employers (apart from participating together in the MEP) and without the pooled plan provider having to qualify as a PEO. The SECURE Act also makes it clear that a plan failure attributable to one participating employer does not taint the MEP as to the other participating employers. As further described below, the pooled plan provider must meet certain requirements, and participating employers retain fiduciary duties in selecting and monitoring the pooled plan provider. But overall these new rules should lead to new MEP plan offerings that will make it easier for smaller employers to offer more cost-effective 401(k) plans to their employees.

TAKEAWAYS: There will be a number of rules that will need to be adopted by the IRS and DOL to implement these new MEP rules. For example, pooled plan providers will need to register as such with the IRS and DOL, provide disclosures to participating employers, and provide annual reports to the DOL, all under rules to be established by the agencies. Also, the new rules do not address MEPs that are defined benefit plans or group health plans.

BACKGROUND

On December 20, 2019, the SECURE Act was signed into law. This article focuses on a new opportunity created by the SECURE Act for expanded offerings of 401(k) and other defined contribution retirement plans to groups of smaller employers through a multiple employer plan ("MEP") sponsored by a "pooled plan provider."[1]

For certain small employers, maintaining a retirement plan can be prohibitively costly. In order to take advantage of economies of scale, some groups of small employers band together to form a single plan – referred to under Section 413(c) of the Internal Revenue Code (the "Code") as a MEP.

Before the SECURE Act, the ability to take advantage of MEPs was limited by rules under the Code and the Employee Retirement Income Security Act of 1974 ("ERISA"). In particular, DOL rules under ERISA permitted MEPs only if the participating employers had a sufficiently common business interest apart from provision of benefits.[2] Recent DOL proposed regulations would have made it somewhat easier for employers to show a sufficiently common business interest, including through geographically-based associations or PEOs.[3] But under those proposed regulations, an "open" 401(k) MEP offered to a group of unrelated employers, bound together by nothing other than common participation in the MEP, was not permitted. MEPs have also been subject to a "one bad apple" rule, meaning that a disqualifying defect by one adopting employer in the plan can disqualify the entire plan, thereby increasing the compliance risks for all participating employers.[4]

As discussed below, the SECURE Act makes "open" MEPs possible. The SECURE Act provisions address only 401(k) or other defined contribution MEPs, and does not address defined benefit plans or group health plans intended to operate as MEPs.

"OPEN" MEPs UNDER THE SECURE ACT

The SECURE Act amends the Code and ERISA to ease the rules for defined contribution MEPs in two important ways:

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[1] For more information on the SECURE Act impact on 401(k) and other retirement plans, see our February 2020 WRMarketplace alert {hyperlink}.
[2] DOL Advisory Opinion 2012-04A.
[3] For more information about the DOL proposed regulations, see our August 2019 WRMarketplace alert {hyperlink}.
[4] Treas. Reg. Sec. 1.413-2(a)(3)(iv).

- The new rules eliminate the "common interest" requirement. Unrelated employers without a business relationship (apart from participation in a shared MEP) will be able to participate in a MEP through a "pooled plan provider" that meets certain requirements.

- The new rules eliminate the application of the "one bad apple" rule if the assets and liabilities of the plan attributable to the noncompliant employer are spun-off into a separate plan, thereby making participation in a MEP less risky.

The new rules become effective for plan years beginning after December 31, 2020. Regulatory guidance from the IRS and DOL will be needed to implement the new rules, and qualified "pooled plan providers" will need to step forward to offer open MEPs in the manner contemplated by the new rules.

REQUIREMENTS TO QUALIFY AS A POOLED PLAN PROVIDER

To meet the requirements of the SECURE Act, the MEP will need to be sponsored by a pooled plan provider that meets the following requirements:

- The person serving as the pooled plan provider must be designated under the MEP as the plan's "named fiduciary" and "plan administrator" (as those terms are used under ERISA) and be responsible for all of the administrative duties necessary to run the plan for each participating employer and to ensure that the plan meets all of the applicable tax qualification requirements under the Code for each participating employer.

- The person must register with the IRS and DOL as a pooled plan provider in accordance with rules to be developed by the agencies.

- The person must acknowledge in writing its status as the named fiduciary and plan administrator for the MEP.

- The person must ensure that all other persons who handle MEP assets are properly bonded under ERISA.

The SECURE Act rules are intended to prevent participating employers from becoming trapped in a poorly run MEP. The pooled plan provider must ensure that the MEP does not include unreasonable restrictions, fees, or penalties on participating employers that want to leave the MEP. The pooled plan provider must also provide participating employers with disclosures and information that allow the participating employers to properly monitor the pooled plan provider. The pooled plan provider will likely have to file special Form 5500 annual reports that include information about the participating employers in the MEP, allowing the government to better track the use of open MEPs.

These requirements do not appear to impose significant obstacles to companies entering the market as pooled plan providers.

ONGOING FIDUCIARY DUTIES OF PARTICIPATING EMPLOYERS

In addition to cost advantages from economies of scale, an open MEP should make it administratively easier for small employers to offer 401(k) and other defined contribution plans to their employees by offloading much of the administrative work and fiduciary oversight to the pooled plan provider. These activities assigned to the pooled plan provider will likely include selecting and monitoring the plan investment choices. But the SECURE Act does not relieve participating employers from all legal obligations related to the MEP.

Importantly, each participating employer retains ERISA fiduciary duties in the initial selection of a pooled plan provider and in the ongoing monitoring of the services provided by the pooled plan provider. In other words, each participating employer will need to receive information sufficient to determine, in a prudent manner, that the pooled plan provider is itself managing the MEP prudently and for the exclusive benefit of plan participants and their beneficiaries. Participating employers will need to review and understand the fees being charged by the pooled plan provider in relation to the services provided, the fiduciary processes that the pooled plan provider intends to follow in selecting and monitoring plan investment choices, etc. If a participating employer becomes aware that a pooled plan provider is breaching its fiduciary duties, it possibly could be subject to ERISA claims as a "co-fiduciary." In this respect, the participating employer's ERISA fiduciary duties are likely similar to those when selecting and monitoring other vendors for a plan, such as investment advisors and third party administrators.

ELIMINATION OF "ONE BAD APPLE" RULE

A participating employer could take actions that trigger operational errors in a MEP. For example, the participating employer might fail to timely make contributions, provide inaccurate data that leads to incorrect nondiscrimination testing, etc. Under prior law, a compliance failure by one participating employer had the risk of tainting the qualified plan status for the entire MEP – i.e., "one bad apple ruins the bunch."

This "one bad apple" risk potentially creates a disincentive for participating employers to join together in MEPs. An operational failure of a tax-qualified plan can, in the worst case, lead to plan disqualification, which includes huge tax penalties to both the employer and participants. Lesser penalties may be assessed for failures that are discovered on audit with the IRS and corrected through a closing agreement.

The new SECURE Act rules provide that plan qualification errors attributable to a participating employer's failure does not "ruin the bunch." Rather, the participating employer's participation in the MEP is transferred to a separate plan, walling off the other participating employers from the adverse plan qualification consequences of the participating employer who is the "bad apple."

NEXT STEPS

As noted earlier, the new SECURE Act rules do not become effective until plan years starting after December 31, 2020. The new rules require additional regulatory direction on how permissible open MEPs may be established, including details on how persons can qualify as pooled plan providers, the types of reporting required by pooled plan providers, etc. The new rules contemplate that the IRS will publish model plan provisions for a qualifying open MEP.

Meanwhile, businesses looking to become pooled plan providers will need to begin thinking about how to set up their MEP plans, who their target market might be, whether they can meet all of the requirements to qualify as a "pooled plan provider," and the types of information they will need to provide prospective participating employers that will allow those employers to make prudent fiduciary decisions.