DOL PROPOSES NEW MULTIPLE EMPLOYER PLAN RULES: EVERYTHING YOU NEED TO KNOW

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The Department of Labor (DOL) has announced proposed regulations that would make it easier for associations and professional employer organizations (PEOs) to offer retirement savings plans to their members through Multiple Employer Plans (MEPs). The MEP proposal would allow certain small businesses to band together to offer more robust 401(k) plans to their employees and achieve significant savings. While the new regulation is certainly a step in the direction, it doesn't go as far as many had hoped.

The flavors of MEPs

Not to be confused with multiemployer plans, which are collectively bargained plans offered by unions, a MEP refers to a single plan formed by two or more different employers. MEPs generally fall into two flavors, "closed" and "open."

- CLOSED MEPS — A closed MEP is a single plan sponsored by a "cognizable, bona fide group or association" acting in the interest of its members and requires employer members to have a "commonality of interest," such as operating in the same industry, and exercise either direct or indirect control over the plan. These types of MEPs are allowed under the current law.

- OPEN MEPS — An open MEP is formed by two or more employers who have no commonality. In this case, you could have a trucking company in Ohio join a dental office in Dallas to form a single plan. These types of MEPs are not allowed under the current law.

How MEPs work

A MEP allows employers to participate in a single retirement plan, sharing a single plan administrator, recordkeeper, and investment advisor. MEP employers no longer file their own Form 5500, obtain an audit, maintain a fidelity bond, or retain the responsibility for day-to-day administration. For plan design purposes, a MEP works in the following way:

- ELIGIBILITY — The plan must apply the minimum age and service requirements under Internal Revenue Code (Code) §410(a) as if all employers are a single employer. For example, service with all the participating employers is counted in determining an employee's eligibility to participate in the plan.
- EXCLUSIVE BENEFIT RULE — The exclusive benefit rule is applied as if the employers are a single employer. This permits the allocation of contributions and forfeitures across company lines without violating the rule that an employer's contributions must be made for the benefit of its employees and former employees.
- VESTING — The Internal Revenue Service (IRS) treats the employers as a single employer for vesting purposes. For example, service with all the member employers is counted in determining an employee's position on the vesting schedule.
- ANNUAL PLAN LIMITS — Benefits and contributions attributable to a participant from all member employers must be considered for determining limits on elective deferrals, catchup contributions, employer contributions, and annual compensation limits.
- COVERAGE, NONDISCRIMINATION AND TOP-HEAVY TESTING — All testing rules are performed by each participating employer as if that employer maintained a separate plan.
- FIDUCIARY RISK — There is a reduction in fiduciary risk exposure because the member employer ceases to perform certain key roles that incur fiduciary status. The member is no longer the sponsor of the plan, ceases to be a trustee, plan administrator, or any sort of named fiduciary. Those central roles move to the MEP, and the inherent fiduciary liability transfers with them. The relief offered by MEP participation is extensive but not total. Certain responsibilities generally remain with the adopting employer, and even this reduced role must be taken seriously. Those responsibilities include the need to make timely and accurate plan contributions, plan design decisions, such as the level of match, and the decision to adopt or de-adopt the MEP, including necessary due diligence and monitoring of the MEP.

Why MEPs matter

Employer-sponsored retirement plans have become the backbone of the retirement system in the US. Unfortunately, millions of Americans don't have access to a plan through their employer, leaving many unprepared to retire. This retirement coverage gap is prevalent among small employers, many of whom do not sponsor plans due to concerns about costs, complexity, and fiduciary liability. Thus, MEPs make a lot of sense for smaller employers that want to provide a retirement plan as a benefit to their employees but lack the financial and administrative resources to run a plan.

Generally, start-up costs and fees can be significant for smaller employers and are often the main reasons for not offering a plan. A MEP pools the assets of all employers, thus immediately providing buying power and economies of scale for services and investments that the employers on their own would never realize. Not offering a plan leaves small employers at a disadvantage in attracting and retaining talent, especially where the talent came from an employer that offered a plan. Aside from being cost prohibitive, administration of a retirement plan may not be something smaller employers are equipped to do. MEPs give the small employer the ability to offer a full-featured retirement plan without taking on many of the operational and fiduciary responsibilities of a plan sponsor, and potentially at a cost similar to a large plan (because of the pooling of assets).

Problems with MEPs

Despite the benefits, there have been significant barriers to why MEPs are not widely used. Significantly, §413(c) of the Code imposes several requirements on these plans as a condition of maintaining their tax-qualified status. Some of these requirements, such as nondiscrimination rules, are applied on an employer-by-employer basis rather than on a plan basis. If one employer is non-compliant, they could jeopardize the tax status of the entire plan, putting all other employers at risk. This is commonly known as the "one bad apple" rule and would apply to several compliance issues a plan could encounter.

For purposes of ERISA, the DOL has historically treated a MEP as a single retirement plan only if sponsored by a "cognizable, bona fide group or association of employers" acting in the interest of its members. It also requires that this group of employers have a "commonality of interest," such as operating in the same industry, and exercise either direct or indirect control over the plan. These conditions have significantly limited the ability of other organizations, such as a local Chamber of Commerce, to sponsor a MEP for a diverse population of smaller employers. This requirement has prevented open MEPs.

For purposes of risk, many small employers avoid offering a retirement plan because they are concerned about the fiduciary responsibilities and liabilities they might assume under ERISA. The DOL has clearly stated its concern that "open" MEPs could be a breeding ground for promoters to take advantage of employers and their employees similar to the multiple employer welfare arrangement scandals in the 1990s. Combine all of this with the massive increase in retirement plan fee litigation, and many small employers turn away.

President Trump lights a MEP fire

Tired of waiting for the IRS and DOL to act, and with Congressional proposal seemingly at a halt, President Trump signed Executive Order 12857 (the "EO") Sept. 3, 2018, directing the DOL to consider issuing regulations or guidance to make it easier for employers to participate in Association Retirement Plans (ARPs) within 180 days. The EO refers to MEPs as ARPs, but the two should be understood to mean the same thing. The EO also asked the DOL to consider ways for part-time workers, sole proprietors, working owners, and other "entrepreneurial workers with non-traditional employer-employee relationships," to save for retirement, including allowing them in a MEP. The EO further directed Treasury to consider whether to issue regulations and guidance related to the "one bad apple" rule noted above.

DOL responds with new regulations

In direct response to Trump's EO, the DOL issued proposed regulations Oct. 22, 2018, that would allow for the limited expansion of MEPs. We say limited, because the new regulations do not apply to employers with common ownership not in a controlled group, nor do they apply to completely unrelated employers in the open MEP concept. It is also important to note that the regulations are only applicable to defined contribution plans such as 401(k) or 403(b) plans. The regulations essentially provide for two MEP types, association MEPs and PEO MEPs.

Association MEPs

These requirements are similar to the recent association health plans rules the DOL issued. The requirements for the group or association members are:

- Have at least one substantial business purpose unrelated to offering and providing MEP coverage. A substantial business purpose exists if the association would be a viable entity in the absence of sponsoring a plan. A business purpose includes promoting common business interests of its members or the common economic interests in a given trade or employer community and is not required to be a for-profit activity.
- Act directly as an employer of at least one employee who is a participant covered under the plan.
- Have a formal organizational structure with a governing body and bylaws or other similar indications of formality.
- Control the functions and activities of the plan.
- Have a commonality of interest.
- Do not make plan participation available other than to employees and former employees of employer members and their beneficiaries.
- The group or association cannot be a bank or trust company, insurance issuer, broker-dealer, or other similar financial services firm (including pension record keepers and third-party administrators).

PEO MEPs

A PEO is basically a business that contracts with employers to professionally manage their human resource functions. The conditions for a bona fide PEO are different than for an association, and require the PEO to:

- Perform "substantial employment functions" on behalf of the client employers.
- Have substantial control over the functions and activities of the MEP and assume responsibility for the MEP as plan sponsor.
- Ensure that each client employer that adopts the MEP is a direct employer of at least one participant covered by the MEP.
- Ensure that participation in the MEP is available only to employees and former employees of the PEO and client employers.

Whether a PEO meets the "substantial employment functions" requirement is based on a facts and circumstances test considering nine criteria (but not all must be met):

- Payment of wages;
- Reporting, withholding, and paying federal employment taxes;
- Recruiting, hiring, and firing workers;
- Establishing employment policies, conditions of employment, and supervising employees;
- Determining employee compensation;
- Providing workers' compensation coverage under state law;
- Performing integral human resources functions such as job description development, background screening, drug testing, employee handbook preparation, performance review, paid time off tracking, employee grievances, or exit interviews;
- Performing regulatory compliance in the areas of workplace discrimination, family and medical leave, citizenship or immigration status, workplace safety and health, or permanent labor certification programs; or
- Continuing to have employee benefit plan obligations to participants after the client employer no longer contracts with the organization.

The DOL also proposed two safe harbors in order to provide more certainty with respect to the "substantial employment functions" test. The first is for PEOs licensed as certified professional employer organizations ("CPEOs") under IRC §7705. The second safe harbor permits a PEO not licensed as a CPEO to be considered bona fide where the PEO meets five of the nine "substantial employment function" criteria.

Working owners included

The DOL also allows for working owners (i.e., sole proprietors and other self-employed individuals) to elect to act as employers for purposes of participating in an association and may be treated as employees of their businesses for purposes of being able to participate in a MEP. The working owner must work at least 20 hours per week or 80 hours per month on average or have wages or self-employment income equal to or exceeding the working owner's cost of coverage. That test must be met when the employer joins the MEP and confirmed periodically pursuant to reasonable monitoring procedures. Notably, the clarification for working owners does not extend to MEPs sponsored by bona fide PEOs, so employers must have at least one common law employee to participate in a PEO-sponsored MEP.

Fiduciary liability still a question

The DOL makes it very clear that employers participating in a MEP would retain the fiduciary liability for choosing and monitoring the MEP and for remitting required contributions. The actual sponsor of the MEP retains the fiduciary liability for reporting, disclosure, investments, and administration. The DOL also failed to address the "one bad apple" issue noted above, leaving lingering concerns for many employers.

Lockton's take

To be frank, the DOL regulations really do not say much, but instead articulate what we already knew. The real value to create measurable change is in the open MEP concept. Most everyone who followed the last decade of MEPs had hoped that the President's EO would push the DOL to allow fully open MEPs. The retirement coverage gap is real. The ability to pool assets at the small end of the market would open the door to an entire employer segment that was historically not well served. However, the DOL was handcuffed. Doing so would require changes to the law, something a regulatory agency is not empowered to do. Thus, the future of open MEPs lies in the hands of a Congress that seems to be at a clear impasse going into the midterms. Time will tell as to whether the next Congress is willing to tackle this issue, but there are signs that it could happen. Open MEPs have bipartisan support, but whether any retirement policy is important enough for the next majority remains to be seen.

Next steps

As with any proposed regulation, there are many steps to implementation. There will be a notice and comment period open until Dec. 24, 2018. After which, the DOL will then review comments, make any changes it deems necessary, and then issue a final regulation, likely in early 2019. We expect the IRS to issue its own guidance on the tax issues that MEPs face as well. In addition, Congress could throw a significant wrench in the DOL's process as well. Currently there are several legislative proposals that significantly differ from this one, most notably by allowing open MEPs. If Congress were to pass one of those bills, it would preempt the DOL from enacting this regulation. Lockton will continue to monitor the process and provide updates.

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