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Employee Benefit Plan Review

The "New 401(k)"

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Forty years ago, Congress passed the Revenue Act of 1978 and added a single paragraph marked "(k)" to another wise yet obscure section of the Internal Revenue Code. The real purpose was to place more parameters around pre-tax contributions made to cash or deferred plans. In reality, with fewer than 900 words, Congress created what is now a major piece of the retirement system. In 1981, the Internal Revenue Service (IRS) then sanctioned the use of employee salary reductions as a source of contributions. This created a large boom and in a few short years there were over 17,000 401(k) plans by 1984.

The system, which of course was never built to be a replacement for pensions, was built during a time when people worked very differently. Through a series of events, including new accounting rules, defined-benefit plans no longer made sense for many employers. Accordingly, 401(k) plans filled that void.

Have 401(k) Plans Delivered?

Have 401(k) plans delivered all that was promised? For certain larger companies, the creation and operation of a 401(k) plan is a fairly straight forward exercise. However, where these plans have fallen short is the ease of other employers to establish these plans due to costs, administrative duties, and fiduciary concerns. Approximately 38 million private-sector employees in the United States do not have access to a retirement savings plan through their employers, according to the DOL, which cited administrative costs and compliance requirements as the chief reasons why small businesses do not offer a retirement-savings benefit. The Spark 401k Survey (on behalf of financial services firm Capital One) polled 500 U.S. business owners at companies with 50 or fewer employees and found that 59 percent of small business owners said their businesses were too small to set one up, while 16 percent believed plan costs were too high.

Proposed Fix

The Department of Labor (DOL) issued proposed regulations (the Proposal) on October 22, 2018, that represent the first major step in changing its restrictions on multiple employer plans (MEPs). However, this is just the first step, and does not change the landscape for Open MEPs.

It is important to note two things at the outset:

1. The Proposal does nothing to change the rules for Open MEPs. Under the Proposal, plans sponsored by service providers (i.e., banks, trust companies, insurance companies,[1] broker-dealers or similar financial service firms, and specifically including recordkeepers and third-party administrators (TPAs)), do not constitute MEPs under DOL rules.
2. The Proposal does not solve the "one bad apple" rule (which states that a disqualifying defect by any one adopting employer in a MEP disqualifies the entire MEP, and some cite this rule as a reason not to create or adopt a MEP). The hope is that the IRS will issue guidance dealing with this problem in response to the President's Executive *Order*[2] to

strengthen retirement Security in America.

Furthermore, the Proposal addresses only MEPs that are defined contribution plans.

What the Proposal Does

The Proposal addresses two types of situations and makes the rules for qualifying a MEP as a single plan in those two circumstances easier: plans of Professional Employer Organizations (PEOs) and plans of bona fide associations or groups. In particular, for the latter, the "commonality" requirement, which was very complex and arcane, has been significantly simplified: if you are in the same industry or geographic region, you are good to go (assuming certain other requirements are met).

The Deeper Dive

As noted above, the Proposal clarifies and somewhat expands the availability of MEPs in two circumstances: plans sponsored PEOs and associations, or groups.

The MEP for "Bona Fide" PEOs

By way of background, PEOs are entities that contract to provide the employment or HR-related framework for other companies (Company or Companies). As part of the framework, PEOs commonly provide various benefits to Company employees, including retirement plans. Prior DOL guidance did not address PEO retirement plans.

The Proposal treats a PEO plan as one plan, rather than separate plans adopted by each client-employer, if the PEO constitutes a bona fide PEO. To do that, a PEO must:

- Provide substantial employment functions and maintain adequate records relating to such functions;
- Establish control over the functions and activities of the MEP, as the plan sponsor, the plan administrator, and a named fiduciary of the plan;
- Be certain that each Company adopts the MEP and acts directly as an employer of at least one employee who participates in a MEP; and
- Make the MEP available only to employees and former employees of the PEO.

What are substantial employment functions?

The PEO must be responsible for at least some of the following:

- Paying wages to the employees;
- Wage reporting, withholding, and employment taxes;
- Recruiting, hiring, and firing workers of the Company;
- Establishing employment policies and conditions of employment, and supervising employees;
- Determining employee compensation;
- Providing workers' compensation coverage;
- Providing human resource functions of the Companies, including complying with regulatory rules for workplace discrimination, family and medical leave, citizenship or immigration status, workplace safety and health, etc.; and
- Maintaining employee benefit plan obligations to participants after the Company ceases to contract with the PEO.

The guidance creates safe harbors related to the first requirement of performing substantial employment functions:

- If the PEO qualifies as a Certified PEO (CPEO) under Internal Revenue Code Section 7705(a), it must perform only two of the above functions to satisfy the first requirement.
- If the plan provides five of the listed functions, it automatically satisfies the first requirement.
- "Facts and circumstances" test including the potential that compliance with a single function could be adequate to satisfy the first requirement.

Bona Fide Groups or Associations of Employers

The Proposal expands the groups or associations that would qualify to sponsor MEPs and appears to be closely aligned with the recently finalized regulations authorizing Association Health Plans. Under the Proposal, the group or association would be bona fide, if:

- It has at least one substantial business purpose unrelated to offering the MEP and it would be deemed to be substantial if the group can sustain itself if there was no employee benefit plan. Examples include:
  - Promoting common business interests of members
  - Providing continuing education
- Each employer member of the group participating in the plan acts as an employer of at least one employee who participates in the plan.
- The group has a formal structure with bylaws or similar formal structures.
- The group's functions and activities are controlled through employer-members.
- The employer-members have a commonality of interest, which includes:
  - The same trade, industry, or line of business or profession; or
  - The principal places of business in the same region within a single state or metropolitan area
- Plan participation is unavailable to anyone who is not an employee or former employee

of a group member or their beneficiary.
- The group or association is not a bank, trust company, insurance company, broker-dealer, or similar financial services firm or owned or controlled by such an organization.

Covering the Business Owner

An MEP can cover a Company and its working owner, even if there are no other employees and even if the company is not incorporated. A working owner is:

- An individual who has an ownership right of any nature
- Someone who earns wages or self-employment income from the business who works at least 20 hours per week (on average) or at least 80 hours per month. The wages or self-employment income from the trade or business must be equal to at least the working owner's cost of coverage for participation by the owner and any covered beneficiaries in any group health plan sponsored by the group or association

These qualification rules must be met when the owner first becomes eligible to be in the plan, and must be periodically confirmed.

ERISA Fiduciary Matters

The Proposal would permit businesses to join to offer 401(k) plans through association retirement plans (ARPs) and other multiple employer plans. These would be similar to those created by PEOs that assume a majority of employment responsibilities for their client employers. The employers would not be viewed as sponsoring their own plans under ERISA Instead, the PEO-sponsored MEP would be treated as a single employee benefit plan for purposes of ERISA. The MEP sponsor, and not the participating employers, would be responsible as plan administrator for complying with ERISA.

Fiduciary liability may be reduced for participating employers, as the proposal permits the designation of a named fiduciary who will have the responsibility for some but not all fiduciary requirements. One of the downsides of this arrangement would still linger. Specifically, each employer cannot be responsible only for its plan administration. As such, the administrative error of one sponsoring employer may in fact ruin the qualified status of the plan for all employers.

Other Items of Interest

The ARPs can be offered by associations of employers in a city, county, state, or multi-state metropolitan area, or in a particular industry nationwide. Sole proprietors and their families can also be permitted to join these plans.

Although these are proposed regulations, it would seem like many of the aspects would be favorable if included in the final regulations as is and they should provide equivalent standings for certain types of small businesses.

Notes

1. *https://401kspecialistmag.com/so-about-those-proposed-mep-regulations/.*
2. *https://www.whitehouse.gov/presidential-actions/executive-order-strengthening-retirement-security-america/.*

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