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# MEPs and PEPs – Legal and Regulatory Developments

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## What We Will Cover

- Background
- DOL regulations regarding association and PEO multiple employer retirement plans
- IRS proposed regulations providing an exception from the unified plan/one bad apple rule
- Legislative proposals
- What to expect in the future

# BACKGROUND

# MEPs

- A Multiple Employer Plan ("MEP") is a single retirement plan that has been adopted by employers who are not part of the same controlled or affiliated service group.
- In contrast, a Multi-Employer Plan is a plan established through collective bargaining that covers union members  who work at companies who are unrelated to each other.

## MEPs

- MEPs are governed by IRC §413(c) which provides special rules for service crediting and compliance testing of these plans.
- There is no similar provision in ERISA that specifically focuses on MEPs. The relevant ERISA provisions focus on the definition of employer.

# MEPs

- IRC §413(c) defines a MEP as a plan maintained by more than one employer and provides special rules for qualification purposes including:
  - IRC §413(c)(1) & (3) require that service with any participating employer be recognized for purposes of eligibility, vesting and benefit accrual;
  - For coverage and non-discrimination testing, however, each employer is "disaggregated" and tested separately (including the ADP/ACP tests);
  - Like wise, the top heavy rules are applied separately to each individual employer;
  - For IRC §415 limits, all compensation and contributions from any participating employer are aggregated.

# THE DOL AND MEPs

# MEPs – current status

- Advisory Opinion 2012-04A was released on May 25, 2012.
- The opinion holds that the "commonality" required to have a single plan that was previously applied in the MEWA context also applied to retirement plans.
- As a result, most "Open" MEPs will not actually be treated as a MEP but instead will be treated as separate, individual plans under ERISA.

## What does AO 2012-04A mean for MEPs?

- The result was a "chilling" of interest in "Open" MEPs.
- About that time, Congress became interested in MEPs as a cost effective way to promote employer sponsored workplace retirement plans.

# DOL PROPOSED REGULATIONS

# Association Retirement Plans

- On August 31, 2018, President Trump issued an Executive Order directing DOL to "clarify and expand the circumstances under which United States employers, especially small and mid-sized businesses, may sponsor or adopt a MEP as a workplace retirement option for their employees, subject to appropriate safeguard."
- In addition, the EO directed the Treasury Department to consider amending regulations or other guidance "…regarding the circumstances under which a MEP may satisfy the tax qualification requirements … including the consequences if one or more employers that sponsored or adopted the plan fails to take one or more actions necessary to meet those requirements."

# Final Regulations

- On October 23, 2018, DOL published proposed regulations with regard to multiple employer retirement plans to be effective on September 30, 2019.
- On July 31, 2019, DOL published final regulations.
- Different requirements for associations vs. PEOs.
- Applies only to defined contribution plans as db plans present different policy considerations.

# Final Regulations

- MEP can either be an Association Retirement Plan (ARP) or a Professional Employer Organization (PEO) sponsored plan.
- Preamble makes it clear that participating employers retain fiduciary responsibility for choosing and monitoring the arrangement and for forwarding required contributions to the MEP.
- Other fiduciary functions are transferred to the MEP sponsor.

# ASSOCIATION RETIREMENT PLANS

# Association Retirement Plans

- Association Retirement Plans may only be sponsored by a bona fide group or association of employers.
- The association must have at least one substantial business purpose in addition to sponsoring the MEP.
  - Association's primary purpose may be to offer and provide the retirement plan to employer members and their employees.
  - A substantial business purpose exists if the group or assoc. would be a viable entity in the absence of sponsoring an employee benefit plan.
  - Business purposes include promoting the common business interests of its members or the common economic interests in a given trade or employer community.

# Association Retirement Plans

- Each employer member must be acting as employer of at least one employee covered by the plan.
- The group or assoc. must have a formal organizational structure with a governing body and by-laws or similar indication of formality.
- The functions and activities of group or assoc. must be controlled by the members of the group or association and the members that participate in the plan must control the plan.
- Control must be in both form and substance.



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# Association Retirement Plans

- Only employees of members of the group or assoc. may participate in the plan.
- "Working owners" (including self-employed individuals) of a trade or business may qualify as both an employer and an employee. The working owner:
  - Must receive wages or self-employment income for providing personal services to the trade or business;
  - Must work on average at least 20 hours per week or 80 hours per month, or receive wages or self-employment income in an amount sufficient to cover the cost any group health plan sponsored by the assoc.
- The group or assoc. may not be a bank or trust co., insurance issuer, broker-dealer, or other similar financial service firm (including recordkeepers and TPAs) or owned or controlled by such entities.

# Association Retirement Plans

- Members of an association MEP must have a commonality of interest beyond merely adopting the same plan.
- Commonality, however, is much more broadly defined than under prior sub-regulatory guidance:
  - Employers must be in the same trade, industry, line of business or profession; or
  - Each employer must have a principal place of business in the same state or the same metropolitan area.
    - So, a plumber in California would have commonality with a plumber in New York.
    - The California plumber would also share commonality with any employer with a principal place of business in California.

# PEO MEPs

# PEO MEPs

- PEO MEPs are probably the biggest winner in the final regulations.
- A PEO's authority to sponsor a MEP for its clients arises under the wording of ERISA section 3(5) which permits a person to act "indirectly in the interest of an employer."
- A PEO is defined as a human resource company that contractually assumes certain employer responsibilities for its client employers.

# PEO MEPs

- Must be a be professional employer organization (PEO) which is defined as "a human resource company that contractually assumes certain employer responsibilities for its client employers.
- To be "bona fide", the PEO, it must meet the requirements set forth on the next slide.

# PEO MEPs

- PEO requirements:
  - PEO must perform substantial employment functions on behalf of its clients and maintain adequate records (next slide);
  - PEO must have substantial control over the functions and activities of the MEP as plan sponsor (ERISA section 3(16)(B)), Plan Administrator (ERISA section 3(16)(A)) and as the ERISA named fiduciary;
  - PEO must ensure that each client employer is acting directly as the employer of at least one employee participating in the plan; and
  - PEO must ensure that MEP participation is only available to employees and former employees (and their beneficiaries) of the PEO or the PEO's client employers.

# PEO MEPs

- Whether a PEO performs substantial employment functions is based on the facts and circumstance of the particular situation.
- As a safe harbor, a PEO will be considered to be performing substantial employment functions on behalf of its clients if, with respect to the client employer's employees, it satisfies four criteria:
  - The PEO assumes responsibility for the payment of wages to employees of its client-employers that adopt the plan;
  - The PEO assumes reporting, withholding, and paying any applicable federal employment taxes for its client employers that adopt the plan;

# PEO MEPs

- Must perform substantial employment functions and maintain adequate records (cont'd):
  - The PEO must play "a definite and contractually specified role in recruiting, hiring, and firing workers of its client employers that adopt the MEP."
    - This can be exercised in tandem with the client employer.
    - It is sufficient if the PEO simply retains the right to recruit, hire and fire workers of its client employers.
- The PEO must assume 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.

## Challenge to Association Health Plan Regulations

- A recent case, which vacated the final AHP regulations, New York v. United States Dep't of Labor, No. CV 18-1747, 2019 WL 1410370 (D.D.C. Mar. 28, 2019) has raised questions as to whether the ARP regs may be subjected to a similar challenge.
- The DOL has appealed the decision and the Court has granted expedited review.
- The DOL included a "severability" provision so that if part of the regulation is vacated, the remainder of the regulation should remain valid.

# IRS PROPOSED REGULATIONS – THE UNIFIED PLAN EXCEPTION

# Unified Plan Rule Exception

- Regulations under IRC §413(c) provide that a failure by one employer participating in a MEP to satisfy the qualification requirements results in the disqualification of the entire plan.
- This has commonly been referred to as the "one bad apple" rule but is referred to by the IRS as the "unified plan" rule.

# Unified Plan Rule Exception

- In response to the President's 2018 Executive Order on Retirement Security, the IRS recently proposed regulations that will provide an exception to the unified plan rule if certain requirements are satisfied.
- In other words, if the conditions of the proposal are satisfied, the one bad apple will not disqualify the plan.
- The proposed regulations, however, may not be relied upon and will only be effective when issued in final form.

# Types of Failures

- There are 2 types of failures to which the exception to the unified rule will apply -
  - Potential qualification failure is a qualification failure the MEP plan administrator reasonably believes exists but can not be determined solely due to the unresponsive participating employer's failure to provide data, documents or any other information necessary to determine its compliance with the qualification requirements.
  - Known qualification failure is a failure that is identified by the MEP plan administrator and is attributable solely to an unresponsive participating employer.
  - An unresponsive participating employer (UPE) is a participating employer who fails to comply with reasonable and timely requests for information needed to determine compliance with the qualification requirements or fails to take corrective action as requested by the MEP plan administrator.

# Unified Plan Rule Exception

- The proposed regulations have four major requirements for a MEP to qualify for relief -
  1. Eligibility - the MEP must certain meet certain eligibility requirements.
  2. Notice - various notices must be provided to the unresponsive participating employer, participants and potentially the DOL.
  3. Spinoff and Termination - If no corrective action is taken by the unresponsive employer, the plan assets and account balances attributable to the employees of the UPE must be spun off and the plan then terminated.
  4. Compliance with Information Requests - the MEP plan administrator must comply with any request for information about the spun off plan from participants and/or the IRS.

# Eligibility Requirements

- To be eligible for the relief, the MEP must satisfy the following conditions -
  - The MEP plan administrator must have established practices and procedures that are reasonably designed to promote and facilitate overall compliance (including procedures for obtaining information from participating employers).
  - The plan document must describe the procedures that the MEP plan administrator will follow to address participating employer failures including procedures as to what actions will be taken if a UPE does not take appropriate action. (The preamble indicates the IRS will issue model language when the regulation is finalized.)
  - The MEP must not be under an IRS examination (generally determined as of the date the first notice is given).

# First Notice Requirement

- A first notice must be sent to the UPE with the following information –
  - A description of the potential or known qualification failure.
  - A description of the remedial actions that the unresponsive employer would need to take to remedy the failure.
  - A statement informing the UPE that as an alternative, the UPE may choose to spinoff the assets and account balances attributable to its employees to a different single employer plan it sponsors.
  - An explanation of the consequences under the terms of the plan if the UPE doesn't take remedial action or spin off the assets and account balances.
  - The explanation should also note the possibility that the assets and account balances of the employees of the UPE may be spun off to a separate plan that will then be terminated.

# E-Communication of Notice

- Any notice required by the proposed regulation may be provided in writing or electronically
- Any notice provided electronically to a participant or beneficiary must meet the requirements of Reg. section 1.401(a)-21.
- Among other things, the regulation would require either
  - Prior consent by the participant; or
  - The electronic medium is one the participant or beneficiary has the effective ability to access.

# Second Notice Requirement

- If the UPE fails to take corrective action or initiate a spinoff within 90 days of the first notice, a second notice must be given.
- The second notice repeats the information in the first notice with an additional warning that the MEP plan administrator will provide notice the DOL and to plan participants who are employees of the UPE describing the potential or known qualification failure and the consequences of not correcting the failure.
- The second notice must be given within 30 days after the expiration of the 90 day period following the first notice being given.
- One would think that potential notice to the DOL should get the attention of the UPE.

# Third Notice Requirement

- If the UPE fails to take corrective action or initiate a spinoff within 90 days of the second notice, a third notice must be given not later than 30 days after expiration of the second 90 day period.
- The third notice must also be given to participants who are employees of the UPE as well as the DOL.
- The third notice must include the information in the first notice, the deadline for employer action, an explanation of any adverse consequences to participants in the event of a spinoff and termination and a statement that the notice is being provided to employees and DOL.
- **NOTE: If at any time a potential qualification failure becomes a known qualification failure, a new series of notices must be provided with updated information.**

# Options for Correction

- The UPE has three options when it receives notice of a potential or known qualification defect –
  - Demonstrate to the MEP plan administrator that the perceived qualification defect does not exist;
  - Take appropriate remedial action to correct the defect as directed by the MEP plan administrator; or
  - Initiate a spinoff by directing the MEP plan administrator to transfer the assets an account balances of the affected employees to a separate plan of the employer.
- If the UPE initiates a spin-off, it must be completed within 180 days of the employer's request.

# Deadline for Employer Action

- If the UPE has not taken corrective action or initiated a spinoff by the deadline, the MEP plan administrator must take the following steps –
  - Send notification to participants who are employees of the UPE (with the information described on the next slide);
  - Stop accepting contributions from the UPE;
  - Initiate action to spin off the assets to a separate plan that has the same plan administrator, trustee and substantive plan terms as the MEP;
  - Terminate the spun off plan and distribute assets to participants and beneficiaries.

# Contents of Participant Notice

- The participant notice must include the following -
  - Identification of the MEP plan;
  - Contact information for the MEP plan administrator;
  - The effective date for the spinoff termination;
  - A statement that -
    - No more contributions will be made to the MEP;
    - As soon as practicable after plan termination, participants and beneficiaries will receive a distribution of benefits; and
    - Further information will be provided before the distribution occurs.
- A copy of the third notice is filed with the Office of Enforcement of the Employee Benefit Security Administration in the DOL.

# Spinoff Plan Termination

- In terminating the spun-off plan, the MEP plan administrator must –
  - Reasonably determine whether the qualified joint and survivor annuity rules apply to plan distributions, and if so, take steps to reasonably comply;
  - Provide each participant and beneficiary with their accrued benefit as of plan termination (with gains or losses up to the date of distribution);
  - Provide each participant and beneficiary with a section 402(f) notice; and
  - File appropriate forms with the IRS to report the spinoff termination.

# Qualification of Spun-Off Plan

- The separate plan that is spun-off by the plan administrator retains the qualification defect that arose under the MEP.
- Nevertheless, the proposed regulations provide that participants and beneficiaries will not, solely because of the defect, fail to be eligible for favorable tax treatment unless he/she was a responsible party against whom the IRS reserves the right to pursue "appropriate remedies."
- A responsible party is someone (such as the owner of the UPE) who is responsible for the defect.

# Conclusion

- The proposed regulations will require detailed plan language to specify the processes and procedures to be followed.
- From start to finish, given the 90 day notice periods, the process of spinning off the "one bad apple" plan will take close to year, if not longer.
- The proposed regulations can NOT be relied upon so until they are finalized, the one bad apple rule stands.
- Proposed legislation would provide a new statutory exception that would likely require new rules to implement and may effectively override the proposal.

# LEGISLATIVE PROPOSALS

# SECURE

## SETTING EVERY COMMUNITY UP for RETIREMENT ENHANCMENT ACT of 2019 (SECURE)

# The 116th Congress

- On April 1, 2019, Senators Chuck Grassley (R-IA) and Ron Wyden (D-OR) jointly introduced the Retirement Enhancement and Savings Act of 2019 (RESA) (S. 972).
- On May 24, 2019, the House passed the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE) (H.R. 1994) by a vote of 417-3.
- The bill moved to the Senate where the hope was it would pass by unanimous consent.
- Several senators objected, however, and they put a hold on the bill.
- There is still a great deal of bi-partisan support and passage before year end is still quite possible.

# Pooled Employer Plans (PEPs)

- Pooled Employer Plans ("PEPs")
  - Allows for Open MEPs with no Commonality if certain requirements are met
- PEP Benefits
  - Single Plan Document
  - Single Form 5500 Filing
  - Single Plan Audit
- Significant compliance requirements
- Under SECURE, effective for plan years beginning after 12/31/20. Under RESA 2019, effective for plan years beginning after 12/31/22.

# Pooled Employer Plans (PEPs)

- Single 401(a) individual account plan with a tax-exempt trust or a plan of 408 individual retirement accounts;
- That provides benefits to employees of 2 or more employers;
- The PEP plan document must designate a "pooled plan provider" ("PPP");
- PPP is a named fiduciary under ERISA and acts as the 3(16) plan administrator; and
- Selection (and monitoring) of the PPP is a fiduciary plan sponsor responsibility.

# ADDITIONAL LEGISLATIVE PROPOSALS

# Consolidated Filing of Form 5500

- Included in both RESA and SECURE is a consolidated Form 5500 option under which a single Form 5500 could be filed for a group of plans that have:
    1. the same trustee;
    2. the same one or more named fiduciaries;
    3. the same 3(16) plan administrator;
    4. the same plans year; and
    5. the same investments or investment options.
- Effective for 2021 plan year returns.

# WHAT TO EXPECT

# What to Expect

- Given the bi-partisan support for expanding the reach of MEPs, legislation is expected to pass at some time, the question is when?
  - It is unlikely that precious floor time in the Senate will be spent on passing SECURE, but that could change.
  - SECURE could also be appended to one the "must pass" bill to fund the government for the current fiscal year.
- The ability to pass any substantive legislation in 2020 will be a challenge because of the Presidential and Congressional election cycles.
- The result could be déjà vu all over again with hopes for passage in a lame duck session of Congress after the 2020 elections.