



Flashpoint: SEP, MEP, or PEP Identifying the Key Differences in Retirement Plans

The attached white paper by Alison Cohen and Ilene Ferenczy was commissioned by Transamerica Retirement Solutions, LLC to help explain the differences between single-employer, multiple-employer, and pooled-employer plans, as well as other group programs for offering retirement benefits.

Please feel free to download the paper and share it with your friends, colleagues, and clients.

If you have any questions, please call one of us! We are all here to help.

Best regards and stay healthy!

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SEP, MEP, OR PEP: IDENTIFYING THE KEY DIFFERENCES IN RETIREMENT PLANS

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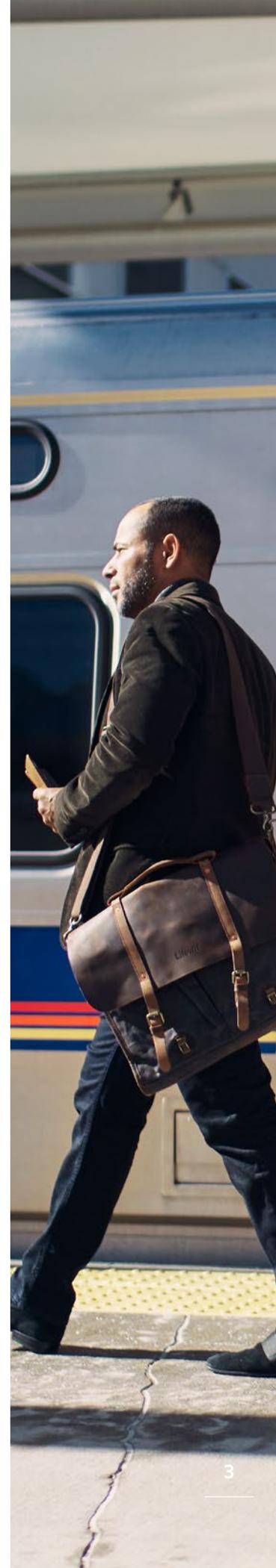
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Twenty years ago, life was simple — at least when it came to workplace retirement plans. In general, each employer that wanted to sponsor a defined contribution plan (such as a 401(k) plan) adopted its own individual plan.

There weren't many choices of how to structure this program, outside of the single employer plan (SEP), and the breadth of available pricing options and investment product types was generally dependent on the plan's size, meaning smaller plans had significantly fewer options.

The world has changed dramatically, and plan sponsors, as well as pension professionals, often get confused as to what type of retirement program will work best for a particular employer, its participants, and its retirement plan. This paper will identify the main types of plan structures that can be used, the pros and cons of each, and cues as to which might be the right fit in a given situation.

It is important to note at the outset that employers that sponsor retirement plans are fiduciaries under the law and owe duties of care and loyalty to their employees. While the structures discussed in this paper may provide a delegation of some of those duties to others — thereby eliminating some of the obligations and liabilities of the employer — there is no vehicle that can completely eliminate all fiduciary responsibility. The employer is always responsible for making sure the plan is properly established and maintained, and must prudently choose and monitor those to whom fiduciary duties are delegated and who provide services to the plan.



SINGLE EMPLOYER PLANS (SEPS)



The Employee Retirement Income Security Act of 1974 (ERISA) is the main law that governs retirement plans. Section 3(16)(B)(i) of ERISA defines a “plan sponsor” as “the employer in the case of an employee benefit plan established or maintained by a single employer.” Without going too far into the technical weeds, SEPs are retirement plans sponsored by a single employer entity and cover only the employees of that entity.¹

A SEP can also be sponsored by controlled groups of companies, as defined under Internal Revenue Code (the “Code”) §§414(b) and (c), and affiliated service groups, as defined under Code §414(m). For those who don’t speak ERISA, controlled and affiliated service groups are combinations of companies that have either significant common ownership or some common ownership but jointly provide services to each other or to third parties. The law treats companies that are controlled or affiliated groups as one big entity, and the employees of the related companies are considered to be employees of that one entity. For example, if Company A has a wholly owned subsidiary, Company B, that is a controlled group. If Company A sponsors a 401(k) plan and Company B also adopts and participates in Company A’s plan, that is considered a SEP because of the controlled group relationship, even though the plan covers two companies. Similarly, if Dr. Jones owns a medical practice, and also a percentage of a surgical center where she operates on her patients, the practice and the surgical center are likely to be an affiliated service group. If a 401(k) plan covers both the practice and the surgical center employees, it is a SEP. These are two examples of related companies; the determination of whether a group of entities is a controlled and/or affiliated service group should be made by a legal or tax professional.

ADVANTAGES OF SEPs

- 1. Maximum Flexibility.** SEPs maximize the sponsoring company’s control over the plan, as well as the administrative and fiduciary responsibility of the company. SEPs allow an employer to fully customize its plan design, based on the goals of the employer and the needs of its employees. So, if an employer wants to offer a 401(k) with all the available bells and whistles, as well as the complexities associated with those features, it can do so. In the following years, the employer has the flexibility to change some, or all, of those features (subject to legal limitations on plan amendments). Employers may have complicated arrangements for different benefits for union employees within the same plan as the nonunion employees. Or perhaps the employer has merged multiple plans from companies it acquired along the way that require benefits earned in those earlier plans be protected. Generally, the only way to accommodate these types of complex considerations is for the employer to sponsor its own SEP.
- 2. Maximum Control.** The sponsoring employer is fully responsible for the operation of the SEP it sponsors; it is not dependent on or affected by the goals, decisions, or actions of other parties. The other plan structures discussed in this paper are sponsored or managed by others, so an employer may need to obtain cooperation or permission from others for certain plan provisions or to ensure plan compliance requirements are met. The management by or involvement of other entities may also lead to restrictions and mandatory procedures with which the employer must comply. In a SEP, there is no ambivalence about where the buck stops: it stops with the sponsoring employer, who may then choose to hire service providers to help manage the administrative burdens of the plan.

Having this level of control also means the employer has access to all plan data, plan documents, and other information. It does not need to go through another entity to get information or to resolve problems that may arise periodically. (Note, however, that multiple employer programs, including both exchanges and MEPs, are often set up to provide easy access by a given employer to the data relating to its own employees.)

¹ The abbreviation “SEP” also refers to Simplified Employer Plans, which are IRA-based plans for smaller employers. This other definition should not be confused with the single employer plans discussed in this paper.

3. You Choose the Service Providers. Another advantage of a SEP model to consider is the ability for the employer to choose the service provider(s) who will work on the plan — and change the service provider(s) at its discretion. If a plan sponsor isn't happy with the quality or the cost of the service, it can unilaterally decide to select another service vendor and move the plan or negotiate better pricing. When using the other models described below, the employer is a small part of a larger whole and is unable to call the shots on any of the service vendors.

Flexibility is also relevant when the employer is a possible acquisition target or, conversely, acquires other entities. Plan mergers, either to combine the employer's plan into the buyer's plan or to fold the plan of acquired companies into the employer's plan, are considerably easier to manage if the employer sponsors and controls a SEP. It becomes more difficult if the employer is participating in a multiple-employer arrangement because the cooperation of others is required.

4. Start-Up Tax Credit. When a small employer (one with fewer than 100 employees) starts a new plan (and hasn't had another plan in place covering the same employees within the past three years), the employer can take a tax credit equal to 50% of the plan's start-up and administrative costs that are paid by the employer (the credit is not available if the expenses are paid by the plan). The credit is the greater of (a) \$500; or (b) \$250 per non-highly compensated employee who is eligible to participate. The maximum annual credit is \$5,000, and the credit applies only for the first three years. While the credit covers 50% of these costs, the other 50% is tax-deductible. The net result: Uncle Sam will pay more than half the cost of the plan for the first three years for most small employers. It is currently unclear whether an employer that joins a MEP or PEP would be entitled to this credit.

DISADVANTAGES OF SEPs

- 1. Significant Responsibility.** Having the entire plan universe at an employer's disposal can be overwhelming for some. Employers may struggle with making the "right" decisions and the related fear of making a mistake. The fear of failure can cause employers to freeze up, leaving the plan lacking administration for a significant time. The result is usually worse than the "bad decision" might have been. While some SEP models build in limitations to protect an employer from its own powers and authority, there are times when the employer is better off relying on professional plan management.
- 2. Plan Sponsor as Expert.** Many employers don't have the personnel or technical savvy to fully understand how to operate a retirement plan. Under ERISA, the plan sponsor must fulfill its plan duties in the same manner as a prudent person with knowledge of the plan and its requirements. This is a very high standard, particularly for company management concerned primarily with running its own business. An employer that sponsors a SEP has the obligation to gain the requisite knowledge and ability to properly operate the SEP. This may be achieved by engaging experts such as financial advisors, third party administrators, and professional 3(16) plan administrators. At the end of the day, the burden and the potential liability fall on the employer's shoulders.
- 3. Cost.** The last disadvantage, and probably a large driving factor for many employers, is cost. The cost of investing and operating the plan is not much different for a very small plan with few assets and a plan that has been operating for many years. Therefore, this cost may be disproportionately high for a small plan with less than \$10 million in assets. We are all familiar with the contrast in cost between shopping retail, visiting a wholesale big-box store, and getting merchandise directly from the manufacturer. Those with access only to retail generally pay more. Smaller-end SEPs are similar to the retail shopper: They will pay retail for the investments and the services they need, and that will likely be the most expensive option, whether analyzed as a percentage of plan assets or on a per-participant basis. Other models discussed below may be more suitable for small employers, as they offer access to better pricing as part of a bigger pool of assets and participants.



WHEN ARE SEPs THE BEST CHOICE?

So, what type of employer might do best with a SEP model? SEPs work well for large employers with complex designs, perhaps including formerly merged-in plans with protected benefits, or designs that allow different benefit structures for different groups of employees. Other good candidates for the SEP model include:

- High-end employers that demand white-glove service and chic designs to benefit certain key individuals within their management ranks
- Employers with union groups that need to have a SEP to comply with the collective bargaining agreement
- Employers that have large controlled or affiliated service groups that they want to keep isolated
- Employers that feel comfortable with the operation of a long-standing SEP
- Employers that like to control their plans and have freedom to choose their own service providers

ALTERNATIVES TO SINGLE EMPLOYER PLANS

- Because of the costs and complexities associated with SEPs, service providers have created structures that give employers viable alternatives. Some of these options have been around for ages; others are relatively new. In general, all strive to provide business owners with some level of reduced responsibility and liability, coupled with economies of scale that come from having more assets working together. All have advantages and disadvantages.
- These other options are discussed below, in the order of the highest level of employer involvement and flexibility to the least

GROUP NEGOTIATED CONTRACTS



Certain recordkeepers have developed a structure in which individual SEPs join together contractually to negotiate as a group for better pricing for recordkeeping and investment contracts. Some of these group negotiated contracts are referred to as “exchanges.”² Usually organized by a service provider, such as a third party administrator (TPA) or investment manager (also known as a 3(38) investment manager or 3(38) fiduciary), exchanges customarily offer some combination of professional fiduciary services, both for the management of the plan and the choice of investment options available to the plan’s participants. However, each adopting employer maintains its own plan, which simply works together with the plans sponsored by other companies to benefit from group pricing and access to services not always otherwise available, particularly to smaller plans.

In an exchange, SEPs join together in a contractual relationship for administrative convenience and economies of scale on investments. The decision to join the other plans in this financial arrangement is made by the SEP sponsor in its fiduciary capacity. The decision to remain part of the exchange is similarly the responsibility of the SEP sponsor. The sponsor has all the flexibility discussed above in relation to plan design.

The exchange organizer generally takes the laboring oar to do the contract negotiating and acts as a focal point for the business side of the exchange. The organizer and the organizations that join in providing services to the exchange commonly accept delegation of some fiduciary responsibility from the SEP sponsors, acting as 3(16) administrators (who become responsible for most of the plan administrative tasks) and 3(38) investment managers, who select and monitor the investment options offered to participants. Some exchanges offer a more robust selection of fiduciary and other services to the adopting employers (AEs). It depends on the contracts that the SEP sponsor signs with the providers. For example, an exchange with several plans that cover more than 100 participants may be able to negotiate more successfully with independent plan auditors, creating a reduction in that significant annual expense, coupled with efficiencies that come from the common management of the SEPs in the exchange.

ADVANTAGES OF GROUP NEGOTIATED CONTRACTS

- 1. Access to Experts.** Because exchanges are commonly organized and maintained by TPAs and investment managers that provide some limited fiduciary services, employers commonly find that their responsibility for typical day-to-day tasks that bog down their HR department, such as approval of distributions and loans, filing Forms 5500, and monitoring eligibility are eliminated or reduced. The exchange’s 3(38) financial manager and/or financial advisor (also known as a 3(21) fiduciary) may also provide access to expert investment advice and oversight that a standalone SEP model cannot afford. In other words, adopting SEP sponsors have access to professional plan services they might not otherwise be in a position to afford. The number, and types, of experts used in a group negotiated contract can vary.
- 2. Potentially Lower Costs.** As noted above, the benefits of group pricing often motivates SEP sponsors to participate in an exchange, which also allows them to avoid some of the disadvantages and controversies surrounding multiple employer plans (MEPs). These lower costs can be viewed in two ways: as compared to a stand-alone SEP and as compared to a MEP.

First, the exchange offers the financial benefits of the pooled pricing of assets, as well as service providers. Therefore, the asset charges and administrative costs may be reduced, depending on the specific exchange design and sub-contracts.

² Transamerica refers to its groundbreaking arrangement as the *Retirement Plan Exchange*®.



Second, as noted above, there are additional legal requirements that apply when a plan reaches a certain size. In particular, plans with more than 100 participants may require annual audits by an independent CPA, which adds significantly to the annual cost of the plan. MEPs are usually large enough to be subject to the audit requirement (which applies based on the number of employees in the MEP, not just those of a given employer). While that audit cost is spread among the participating employers in the MEP (and is expected to be less per employer than an individual plan audit would be), a SEP with fewer than 100 participants does not require an audit. Therefore, whether it is a SEP or part of an exchange, the small employer avoids the audit costs entirely, which is much harder to do in the MEP setting.³

Recent legislation changed the reporting rules for the future, and may permit these group negotiated contracts to file one return for all plans in the group depending on how the participating plans are set up. This may have the advantage of enabling shared costs of that one Form 5500, but may also extend the audit requirement to plans within the group that would normally not need to participate in this process. It remains to be seen whether this type of joint filing will be advantageous.

- 3. Easier Exit Strategy.** If an employer isn't satisfied with the exchange, or a particular service provider within the exchange for whatever reason, it can take its marbles and go home without having to jump through numerous, time-consuming hoops. Additionally, the exchanges may not have exit fees or penalties that may be found in certain MEP arrangements.
- 4. Start-Up Credit.** Because plans that take part in an exchange are SEPs, their sponsors may take advantage of the start-up credit discussed above if they qualify as small employers.

DISADVANTAGES OF GROUP NEGOTIATED CONTRACTS

- 1. Reduced Control.** Like MEPs, exchanges involve contracts with service providers that are negotiated for the entire group. To take advantage of the exchange, the employer must use the service providers that are part of the "bargain." If the employer doesn't like the deal the exchange represents, it is on its own to negotiate the best services it can get for its SEP at the price it can afford to pay.
- 2. Employer Retains Fiduciary Responsibilities in a Structure With Less Accountability.** As is true with all service models discussed in this paper, the employer is ultimately the responsible fiduciary. It is responsible for selecting and maintaining the exchange and must consistently monitor its service providers and all associated fees. However, unlike with a MEP, the contractual relationship of the exchange can be less formal and may not offer as much liability reduction and protection to the adopting employers.
- 3. Investments May Be Restricted.** Certain group negotiated contract models may not permit employers to select their own investments within the plan. It is a fiduciary obligation to ensure that the investment options offered to plan participants are appropriate. Part of the plan sponsor's responsibility is to ensure the investment lineup available to its participants in the exchange is appropriate for the group as a whole. Consideration should be given to the particular needs of the participant base by the employer.

³ The audit requirements for certain MEPs were changed for years beginning in 2021 and later to require such plans to be audited only if they cover a total of 1,000 or more participants or if any covered employer has more than 100 participants. Therefore, fewer MEPs may need to be audited after such time.

MULTIPLE EMPLOYER PLANS (MEPS)



If a SEP is a plan that covers a single employer (including any controlled or affiliated group members), it should be somewhat intuitive that a MEP is a plan covering the employees of more than one employer (that are neither commonly controlled nor affiliated). Historically, MEPs were often sponsored by entities that were related to each other, but not in sufficient amounts to become controlled groups under Code §414(b) or (c). For example, Bob Showman may own 51% of several car dealerships, giving his famous name to each branch. However, 51% common ownership isn't enough to make the dealerships all part of a controlled group. Bob wants to have all of his dealerships under the same plan, since they all use the same payroll and centralized human resources, and employees move among the various dealerships. Bob is allowed to sponsor a MEP that covers all of his employers, subject to certain rules about how the MEP must operate.

Professional employment organizations (PEOs) commonly sponsor MEPs. A PEO provides comprehensive human resources to employers, including managing payroll and issuing Forms W-2 under the PEO's EIN. Prior to 2002, PEOs typically sponsored SEPs for all of the employees on its payroll. The SEP would cover not only direct employees of the PEO, but also all of the employees of its clients. In 2002, the IRS issued guidance (Revenue Procedure 2002-21) clarifying that the employees of the PEO's client-companies were not recognized by the IRS as employees of the PEO itself. Therefore, a plan that covered those individuals had to be adopted by the PEO's client-companies and was categorized by the IRS as a MEP. This was the beginning of the major boom of MEPs in the retirement industry, as PEOs and similar organizations took action to comply with this guidance.

HOW MEPS WORK

A MEP is sponsored by one entity. That entity may be an association, a PEO, certain professional organizations (not a PEO), or an employer that isn't part of a controlled group (like Bob Showman from our example above).

Other employers are permitted by the MEP sponsor to adopt into the plan. These are commonly called adopting employers (AEs) or participating employers. The MEP sponsor controls what companies are given access to the plan. AEs may be companies related to the sponsor through ownership that is insufficient to create a controlled group, like Bob Showman's group. If the MEP sponsor is an association, it may permit member companies to adopt into the plan so as to provide benefits for their employees. (Individual organization members that are not employers cannot adopt into the plan.) A PEO will usually limit participation to client companies. Some MEPs are made available to other companies within a limited geographic area. Other MEPs are sponsored by other professional organizations that are retirement plan service providers and then made available for adoption by the provider's clients. These latter types of plans are called pooled asset arrangements — "open MEPs" — and are discussed below.

The MEP sponsor is responsible for selecting the overall plan design and determining what options will be available for the AEs to select. Some MEPs are very restrictive, whereas others are very flexible. The MEP sponsor is also responsible for making sure the documents and the overall operation of the MEP are in compliance with the law. Although the MEP sponsor is the primary fiduciary responsible for all of these tasks, as well as for selecting the investments available under the MEP, the AE is still a fiduciary with respect to its portion of the MEP. That means the AE is responsible for choosing which MEP to use, for monitoring the MEP sponsor, and deciding to continue participating in the MEP over time. The MEP may also assign certain responsibilities to the individual AE, such as enrolling its eligible employees in the plan. The AE may also need to report payroll and employee information to the MEP sponsor if the MEP sponsor doesn't also perform payroll services for the AE.

The MEP sponsor will contract with any organizations and/or individuals who are engaged to provide services to the plan and may actually provide some of those services itself. A MEP may have (and the MEP sponsor will contract with):

- An administrative fiduciary (i.e., a 3(16) fiduciary) responsible for the operational decisions for the plan, such as determining whether to approve claims, the resolution of any administrative questions, the filing of all reports to the government, and the communications with the employee-participants
- An investment fiduciary (a 3(21) investment advisor or a 3(38) investment manager) to select the available fund lineup for participants to use when investing their plan accounts
- A TPA or recordkeeper to perform the day-to-day ministerial administration for the plan and to maintain the plan's compliance with the legal requirements, such as nondiscrimination testing and reporting and disclosure to the government and the participants
- A recordkeeper to account for the funds and the investments, to interface with the AEs and the investment exchanges, and to ensure participants have access to a website for the investments, plan elections, and information
- A CPA firm for the plan audit, if needed

The MEP sponsor may also make other services available, such as retirement and investment education and advice.

All of the contracts relating to these services are negotiated by the MEP sponsor on behalf of the entire plan and its participants. The MEP sponsor will then determine the pricing amounts and methods for charging the AEs and their participants for those services. Plans or participants may be charged additional fees for using some of the plan features, whereas others are included in a “base price.”

ADVANTAGES OF MEPS

- 1. Economy of Scale.** From a financial perspective, the MEP model touts financial efficiency for its AEs. Because the MEP operates as a single pool of assets for pricing purposes, rather than individual small plans, improved pricing from recordkeepers and other vendors is often available. Of course, the MEP sponsor is providing many services that are customarily performed by the SEP sponsor, so the AE will be paying someone else to do what it might otherwise be doing for no additional charge. It is possible that the fee savings from the MEP’s pricing model will go beyond just offsetting the MEP fees, providing net savings. This is one of the key selling points of a MEP relationship. In other MEPS, rather than reducing the plan costs, the savings are used to provide additional benefits to the AEs and their employees that might otherwise not be available, such as enhanced retirement education or a broader spectrum of plan features.
- 2. “One Plan” Efficiencies.** Substantial efficiencies may be achieved through the MEP model. For example, a single Form 5500 is filed annually by the MEP; individual filings by the AEs are not required. One filing means one independent CPA audit can be prepared for the MEP as a whole, avoiding the need for individual audits for each separate AE plan. (As noted above, SEPs must obtain an audit if the plan covers more than 100 participants.) As the cost of a Form 5500 audit can be expensive for AEs that are required to obtain them, sharing this cost can represent a substantial annual savings. Those servicing MEPS may find that more of their time is spent working with fewer plans than their counterparts whose clientele is made up of many small programs. In that case, they become more familiar with the MEP’s terms, permitting them to provide better and more customized service to the MEP employers and their participants.
- 3. Piggybacking on Other Services.** The MEP may be sponsored by the PEO or may create a relationship with a payroll provider that dovetails with the MEP. An additional efficiency, therefore, is the ability for the MEP sponsor to automatically remit payroll information and employee salary deferrals directly to the plan as part of the payroll process. (This is sometimes called “360-degree integration.”) This relieves the AE from the burden of preparing and uploading payroll information to the recordkeeper and facilitates timeliness and accuracy of that reporting, thereby making contribution deposits easier to calculate. This, in turn, reduces the time lag between the payroll and the transmittal and deposit of the contributions, helping keep the AE in compliance with Department of Labor regulations.

Similarly, the MEP sponsor or other service providers may make available other related services that can be purchased (often at a discount) by AEs or their employees, such as investment counseling or advice.

- 4. Professional Plan Management.** The MEP sponsor takes responsibility for compliance issues and plan management, some of which is handled at the MEP level, and some of which varies from AE to AE. This should free up the AE to concentrate on running its business and leave its HR staff to handle non-retirement plan aspects of employee relations. The MEP sponsor’s administrative responsibilities will include tasks such as processing distributions, answering employee questions, and handling participant loans. If staying current on pension laws isn’t an employer’s core competency, the MEP model can provide valuable relief for the AE.

In 2020, several operational changes will be required for retirement plans as part of the Setting Every Community Up for Retirement Enhancement (SECURE) Act signed into law December 20, 2019. How many employers are up to speed on what these changes entail? As a SEP sponsor, the employer would need to be educated on all the legal nuances and ensure its plan and procedures are fully updated. An AE can rely on the MEP sponsor to take the lead in modifying the plan and its procedures to conform to legal changes. This can be of tremendous value to the time and potential risk of the employer.

DISADVANTAGES OF MEPS

So, why might an employer not want to be part of a MEP?

- 1. I Want What I Want.** Whether the MEP is advantageous depends in good measure on what is important to the employer. If the employer wants to truly customize the terms of the plan, the limited choices available under some MEPS may not provide the best means to meet the employer's needs. A MEP, by definition, is designed to appeal to a broader range of employers, and its efficiencies often depend on simplification. A given employer might feel like the proverbial square peg as it tries to fit in the MEP's round hole. This type of restriction isn't always just limited to plan provisions; the investment options available for participant accounts may be narrower than desired by a given employer. Professionals, such as lawyers and doctors, and other business owners often want to take advantage of a broader range of investment options than mutual funds, including brokerage accounts and real estate. It is possible that a given MEP sponsor may not permit these types of investment vehicles.
- 2. Bad Apples.** The IRS historically has taken the position that if one part of a plan fails to meet the legal requirements, the entire plan is subject to negative tax ramifications. This concept has been colloquially referred to as the "Bad Apple Rule" (as in "one bad apple spoils the whole barrel"), but the IRS recently provided the formal title of the Unified Plan Rule. Because a MEP is one plan — not a grouping of individual SEPs — this rule meant an innocent employer could be a victim of unexpected taxation because the MEP was poorly operated or another AE was noncompliant.

In 2019, the IRS released proposed guidance that would provide relief to a MEP where one individual AE was noncompliant. Under these rules, the innocent part of the plan retains its tax qualification, and the MEP sponsor has the authority to eject the portion of the plan that relates to a noncompliant AE from the MEP. The SECURE Act expanded on these procedures, thereby eliminating concerns that may have deterred employers from adopting into a MEP.

- 3. Loss of Control.** Dependency and trust are two difficult concepts for some people to overcome. Being part of a MEP means an adopting employer will be dependent on the MEP and its sponsor for nearly everything related to the plan. The flip side of having the MEP sponsor responsible for all plan operations is the AE must go to the MEP for what it needs. If the AE wants information or reports from the recordkeeping system, it may have to request the data from the MEP sponsor or service providers. However, some service providers can address this issue by providing AEs direct online access to its specific account information. If participants are requesting a loan or distribution, the request runs through the MEP sponsor for the approval. That leaves the AE and its participants completely dependent on the MEP. Furthermore, the MEP sponsor may be in a position to control (and potentially misappropriate) the money. As a result, the AE needs to investigate what controls and procedures are in place to ensure the plan operates appropriately and safely.
- 4. Is the MEP Really Cost-Effective?** Lastly, the lead hook for why MEPS are valuable — the cost savings — doesn't always materialize. If the MEP sponsor and its service providers aren't able to manage the plan efficiently, or if the sponsor does not negotiate a good "deal" for the plan, then the economy of scale may not work out in the AEs' favor. Additionally, the MEP sponsor may engage other professionals to assist with the management of the plan, such as a 3(38) financial manager or 3(21) financial advisor, that the individual AEs might not have hired if they sponsored a SEP. That can add another layer of fees. Finally, as mentioned above, the MEP may offer increased services or asset models that make the MEP a better plan but may mean cost savings is not the goal or priority for the program.

Adopting employers in a MEP are responsible for prudently determining whether the services offered under the MEP are important to the AE and its employees, and whether the price being charged by the MEP is appropriate. This determination process is one of the fiduciary acts that remain with the AE in a MEP structure. As a prudent fiduciary, the employer must look at the total costs and the services provided under each model — SEP versus exchange versus MEP — to truly evaluate which might work best for its participants.



- 5. The Exit Strategy — Not Necessarily Easy.** The exit strategy is another MEP feature that can be considered a detriment to AEs but an advantage to service providers that sponsor MEPs. Due to limitations on the ability to terminate a 401(k) plan if a new plan is to be established, an employer choosing to leave a MEP can't simply terminate its portion of the plan and pay out its participating employees. The withdrawing employer's portion of the MEP must generally be spun off to a separate SEP before being terminated. The spinoff process requires time and legal documentation, so the AE must be prepared to incur a cost when exiting a MEP. This is another example of the loss of control AEs experience in a MEP, compared to a SEP. On the other hand, this discourages the AE from leaving the MEP on a whim, which increases the retention rate for the MEP sponsor-service providers.
- 6. Employees Under Different AEs Receive Credit for Time Served.** Under the terms of a MEP, individual participants are required to receive service credit for work with other AEs. For example, suppose John works for AE1 for four years and then terminates with 80% vesting. John takes a job with AE2. Because both companies are AEs with the same MEP, John will be given credit for his four years with AE1 and become immediately eligible to participate in AE2. John will also bring with him his 80% vesting, even in relation to contributions made for his benefit by AE2.

This outcome may be untenable for certain employers. They may not want to provide an employer contribution to someone they view as a "brand new" employee, especially if that employee is also going to immediately have vested credit. These requirements and the tracking that they entail can also present considerable challenges for the MEP sponsor and certain service providers. Looking for a service provider that can monitor this closely is going to be key to the administrative success of the MEP.

“OPEN” MEPS



There is a subset of the MEP universe, commonly known as “open” MEPs. The origin of this type of MEP is the Department of Labor (DOL) Advisory Opinion 2012-04A issued May 25, 2012. This opinion letter addressed a service provider created solely to provide a MEP to its customers. Unlike a PEO, the company didn’t provide a full suite of human resource and payroll services. Its sole purpose was to operate a retirement plan for adoption by completely unrelated employers. The service provider served as the MEP sponsor and the 3(16) plan administrator. When the DOL was requested to weigh in, it determined the arrangement was actually a series of individual SEPs, each sponsored by an AE, and not a MEP under ERISA. In particular, the Advisory Opinion made it clear that any MEP sponsored by a service provider, such as a TPA or payroll company that is not a PEO, is not a MEP for its purposes. These structures have come to be called open MEPs because they are open to a full panoply of companies.

To constitute a MEP, the DOL determined there needed to be a relationship between the MEP sponsor and/or the AEs. The AEs could all be part of a common organization, all be PEO customers, or all be in the same industry. (In truth, the source of this analysis and opinion is found, not in multiple employer retirement plans, but in health programs. The DOL was concerned that health plan MEPs were being used to bypass state regulation, so it created a body of interpretation rulings to discourage these programs. Unfortunately, the rules governing retirement plan MEPs are the same, so these interpretations hindered the growth of retirement plan MEPs, as well.)

What is the effect of the DOL treating an open MEP like a series of SEPs? There are two ramifications: First, the MEP must file a separate Form 5500 for each AE in the MEP, as if it was its own separate plan. Second, the annual independent CPA audit rules would apply on an employer-by-employer basis. That is, a given AE would need to have at least 100 participants in its part of the plan for the audit requirement to apply. Rather than one big audit for the entire MEP, there would be individual plan audits and reports.

The end result of this DOL opinion was that an open MEP generally looks and operates just like a standard MEP (also called a “closed” MEP), except for the Form 5500 and audit requirements.

Interestingly, changes in the Form 5500 filing requirements found in the recently passed SECURE Act will likely eliminate this differential between open and closed MEPs, permitting any MEP to file one Form 5500 and have one applicable audit. As a result, this distinction regarding the Form 5500 between open and closed MEPs is expected to disappear.

ADVANTAGES AND DISADVANTAGES OF OPEN MEPS

To the average employer, there is no real noticeable difference between open MEPs and the standard MEP discussed in the prior section, other than the Form 5500 filing requirement. The pricing structure is similar, and the point of control and responsibility still lies with the MEP sponsor. The AE is still a fiduciary with respect to its decision to adopt the MEP and still has the responsibility to monitor the MEP.

For a large employer, however, the separate Form 5500 filing obligation is of material interest. As noted earlier, some larger plan sponsors consider a MEP to spread the expense of the annual audit among several plans, rather than absorbed only by its plan. So, the financial difference between adopting a traditional MEP — where the audit cost is spread among all the AEs — and an open MEP can be substantial.



POOLED EMPLOYER PLANS (PEPS)



PEPs are the new kid on the block. Some people might even call them infants. The SECURE Act created this new plan type when it was enacted in December 2019, but a PEP cannot be instituted until January 1, 2021.

In large measure, PEPs are a compromise between a regular MEP and an open MEP. They provide a structure for service providers to sponsor a multiple employer plan for their clients that is treated as a MEP by the DOL. The separate Form 5500 and audit requirements that were mandated by the DOL for open MEPs will not apply to a PEP. In exchange for this “true MEP” treatment for the PEP, Congress created a new, increased level of responsibility and reporting for the PEP sponsor, which is referred to as the pooled plan provider (PPP). The PPP’s clients — no matter how unrelated — can adopt and participate in the PEP. The PPP is named in the document as the sponsor, plan administrator, named fiduciary, and person/entity responsible for performing all administrative duties. The PPP will be required to register with the Treasury and DOL. (How will this be done? We do not know yet.) Other than the registration aspect, this should all sound very familiar, since it’s essentially required of MEP sponsors already.

The SECURE Act also clarified and codified the relationship of each AE to the MEP. Each AE has fiduciary responsibility for determining the PEP as the appropriate vehicle for its employees’ retirement savings, for monitoring the PEP for proper operations, for approving the fees and costs of being in the plan, and for regularly determining that the PEP remains the appropriate plan for its employees. The SECURE Act also outlined that it is the responsibility of the PEP’s trustee to ensure contributions are collected by the plan for the participants’ benefits.

More information will be available once the IRS and DOL provide guidance to help flesh out the details on how PEPs should operate. For now, it is not entirely clear which of the rules enacted in the SECURE Act in relation to PEPs will be applied across the board to all MEPs.

ADVANTAGES AND DISADVANTAGES OF PEPs

Even though PEPs are new, there are some things we know.

1. **One Plan Filing.** There is only a single Form 5500 required, which offers convenience and cost savings for large employers that would otherwise require a separate audit. It is also noteworthy that the SECURE Act requires the IRS and DOL to create new rules that will allow for the filing of a single Form 5500 for many types of multiple employer arrangements, likely including exchanges and open MEPs, as well as PEPs. Therefore, it is generally accepted that this difference between these different plan types will be eliminated in 2021 or soon thereafter.

Of course, the “one Form 5500” filing requirement also has the potential of pulling AEs into the audit requirement when they would not be subject to otherwise if their plan was a SEP. As noted earlier, the audit requirement has been loosened for some PEPs that are complements of only smaller AEs, and it is possible these reduced obligations will apply to all pooled asset arrangements, including MEPs and group negotiated contracts.

2. **Other MEP Benefits Available.** We also know that all of the benefits of the MEP are applicable for PEPs. These include the cost savings of pooling the trust assets, the reliance on the PPP to have technical knowledge and ability to maintain the operational compliance for the plan, and the advantages of a single point of contact at the PPP.
3. **One Bad Apple Rule Does Not Apply.** As noted above, the SECURE Act eliminated the One Bad Apple Rule for PEPs. The legislation took a similar approach from the proposed IRS regulation and provides the PPP with instructions on how to handle AEs that fail to follow directions, protecting the continued qualification of the compliant part of the plan and permitting the PPP to jettison the part belonging to the bad actor. It is still unclear the extent to which these rules will be applied to other MEPs.
4. **AEs Continue to Have Fiduciary Responsibility.** As noted above, the law relating to PEPs explicitly states that the AEs are fiduciaries with respect to the selection and monitoring of the PPP and any other designated fiduciaries (e.g., financial advisor, designated 3(16) administrator). One additional fiduciary responsibility specifically allocated to the AE under the PEP rules is oversight of the investment and management of its portion of the plan’s assets attributable to its employee participants — unless a 3(38) financial manager has been delegated this duty. Again, there is reason to believe this has been and will continue to be the case for other MEP sponsors, as well.



WHY BECOME A POOLED PLAN PROVIDER (PPP)?

There is an expectation that many existing open MEP sponsors will apply to become PPPs and convert the MEP to a PEP. The mechanics of this process are still unknown. There is also the expectation that TPAs, investment advisors, banks, and others who have been unwilling to get involved in open MEPs will embrace PEPs and become PPPs. The transition from service provider to PPP should be somewhat intuitive, especially if the service provider also offers some level of fiduciary services to its clients.

A third party administrator (TPA) is most intimately familiar with how a plan should operate properly and has the technical skills to be a successful PPP. TPAs often have an existing connection with several smaller clients that could benefit from the financial efficiencies of the PEP model. And, as noted above, participating in a MEP ties the AE more closely to the MEP/PEP sponsor, thereby helping with client retention.

Financial advisors may also want to take PEPs for a spin, particularly as an opportunity to offer more investment-related services to the AEs and their employees. However, it is important for non-administrative PPPs to exercise special caution to ensure they have or retain someone with the expertise to properly manage the plan's administration. Remember, a PPP's primary role is to ensure the PEP is administered correctly.

What would prevent a service provider from becoming a PPP? There is some fear in the industry surrounding the titles of fiduciary, plan sponsor, trustee, etc. The fear of potential financial risk should a mistake occur is probably most common. However, most service providers successfully administer or advise hundreds of plans each year, and mistakes or issues that arise are typically resolved without calamity. There is no logical reason to be concerned mistakes will suddenly happen with the PEP, just because it serves as PPP. (On the other hand, not all providers perform the level of services that a PPP will provide, and one who takes on this responsibility must be prepared to do so with all seriousness.)

A service provider also needs to have the bandwidth to operate a PEP as PPP. In addition to the responsibility of making sure the PEP operates correctly, there is also the reality that a certain amount of marketing will be required to make the PEP financially successful. Sure, there are some benevolent folks out there looking to do this out of the kindness of their heart, but generally, potential PPPs are looking for a financial benefit. Establishing the pricing for the PEP that will be supported by the market space, figuring out how to best market the PEP, and approaching existing clients regarding the opportunity can all feel daunting.

Lastly, budding PPPs will depend on systems available to handle the specific challenges of MEPs. Because some administrative rules in a MEP are applied on an employer-by-employer basis and others are applied on a plan-level basis, recordkeeping challenges must be resolved. Those who provide recordkeeping and software services to retirement plans and their service providers will likely retool to handle the expected increase in MEPs, but not all will be available within the same time frame. Therefore, the service providers who become PPPs will need to be certain they have the systems needed to be effective and successful.

With a thoughtful business plan, thorough documentation, communication materials, and detailed procedures, a service provider can find a new area of success as a PPP.

OTHER “GROUP”

OPTIONS





There are other options available in the market space for smaller employers looking for alternates to the SEP model, usually due to cost considerations and efficiencies. While these models are not as popular as SEPs, exchanges, or MEPs, and not clearly mapped out in any regulation or guidance, they are still viable and legal alternatives.

If several employers simply want to share the same investment vehicle or trust, they can use an 81-100 group trust. This involves establishing a commingled group trust for several SEPs, typically offering a common investment lineup for the participating employers. By creating such a group trust, the trustee/creator has the opportunity to facilitate the same economies of scale as the MEP and exchange models. A group trust must have an institutional trustee and is often created and operated by a financial expert who can serve as the 3(38) financial manager. The 81-100 model requires each SEP to file its own Form 5500, which would include an audit report, if the SEP has sufficient participants. An 81-100 trust may also be a vehicle for a group negotiated contract structure.

Certain states, such as California and Oregon, offer state-run plans modeled after MEPs. Under these models, an employer typically registers with the state and uploads its employee census information.⁴ The employees would then have a choice to opt out of automatic enrollment for pretax salary deferrals, similar to a 401(k) plan. These contributions would be deposited to an IRA managed by the state and its group of investment managers for each enrolled employee (with the investment options and pricing established by such managers and the state). When the employee moves to a different employer, the IRA remains an asset of the employee and can continue to receive contributions. The employer has no obligation to make contributions at its expense for the employee, to perform any nondiscrimination testing to ensure broad-based use of the program by all employees, or to file a Form 5500. It simply needs to fund the employee contributions in a timely manner to the state plan. The contribution limit for these state-run plans usually mirrors the maximum IRA contribution, which is significantly less than the limits for a 401(k) plan.

While this may seem like a good option for smaller employers that don't want the burden of sponsoring a retirement plan of any kind, there has been considerable resistance to voluntarily sharing employee information with the government. In the states offering such an arrangement, the choice may be either participate in the state plan — with the investment and recordkeeping service providers with which the state has contracted — or have any other type of plan. This factor may help drive small employers to strongly consider a MEP or PEP. In addition, sponsoring a 401(k) plan for employees may offer additional tax-savings and advantages to a business owner that are not available through a state-run plan. An affected business owner should ask, "Should I be 'in for a pound?'" — that is, if I'm going to be forced to transmit employee salary deferrals, shouldn't I take advantage of some of the benefits to me, the the business owner, of having a 401(k) plan?

⁴ An appeal has been filed in California challenging the legality of the program on the grounds that it is preempted by ERISA. It remains to be seen whether this state-run program will survive in the long run.

CONCLUSION



As you can see, there are many options and opportunities for an employer to select the right service model for its retirement plan. To best determine what makes the most sense, it is critical to start with a list of what considerations are important to the employer and then match that list to the key benefits of each plan type. And, while costs certainly play a big role and are important to monitor, there is no legal obligation to search out the absolute cheapest option available. It is more prudent to pair the needs of the employer's participants and its owners/executives with the ability of the plan type to meet those needs. That may mean a more expensive option is a better choice. After all, as a fiduciary, it is most important to act in the best interest of the participants and beneficiaries.

Once an employer determines the appropriate plan type, it then needs to shop for the appropriate service provider. Selecting vendors should take as much scrutiny as the service model decision, if not more. Some vendors have the infrastructure in place to handle exchanges and MEPs, while others are simply trying to push a round peg into a square hole. Even if an employer is leaning towards a standalone SEP, there is a vast difference in the types and level of services provided by the various vendors. Take the time to thoroughly review the proposals you receive, try to talk to other employers that have used the vendor, and when possible, rely on your financial advisors to help you sort through marketing hype and get to the facts.



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