Association Retirement Plans (ARPs)

A WHITE PAPER BY

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The entire retirement industry has been devising strategies and product ideas in expectation of receiving new guidance from Washington about multiple employer plans (MEPs). On July 29, 2019, one such piece of guidance arrived in the form of the Department of Labor's (DOL's) final regulation on Association Retirement Plans (ARPs), which opens the door to expanded use of "closed" MEPs by associations, trade groups, chambers of commerce, PEOs, and others.

The Reason for the Buzz about MEPs—Benefits to Employers and Employees

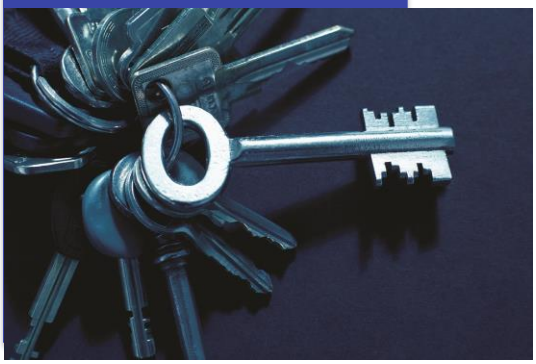
A MEP (multiple employer plan) is a group retirement plan operated by two or more unrelated employers. Here is a sample from the Preamble to the regulation of how the DOL describes the benefits of MEPS:

> "MEPs have the potential to broaden the availability of workplace retirement plans, especially among small employers, because they enable different businesses to band together and adopt a single retirement plan…For a small business, in particular, a MEP may present an attractive alternative to taking on the responsibilities of sponsoring or administering its own plan. The MEP structure can reduce the employer's cost of sponsoring a benefit plan and effectively transfer substantial legal risk to professional fiduciaries responsible for the management of the plan." And "because MEPs facilitate the pooling of plan participants and assets in one large plan, rather than many small plans, they enable small businesses to give their employees access to the same low-cost funds as large employers offer."

The purchasing power made possible by group negotiation, combined with the reduction of duties and risks for employers, has made MEPs a favorite topic in Washington, the states, the media, and across the retirement industry for over ten years.

Background: The Terms "Open" and "Closed" and the DOL's More Restrictive 2012 Guidance

"Open MEP" and "closed MEP" are terms of art, not law, but they are useful. A large portion of the decade-long wrangling in Washington over MEPs has been about making "open" MEPs more broadly available, with "open MEP" being loosely defined as a MEP that anyone can join—any business, no matter what type, and regardless of whether they have a pre-existing relationship or "nexus" with other employers in the MEP.



Guidance from the DOL in 2012[1] said that open MEPs are not single plans for ERISA purposes. That guidance did not mean that such plans are not MEPs for Internal Revenue Code ("Code") purposes (they usually are[2]), or that they are not permitted to exist (they can and do exist). It simply said that open MEPs are not single ERISA plans, with the practical

[1] DOL Advisory Opinion 2012-04A, the "TAG Letter"
[2] IRC Section 413(c) and IRS regulations under it govern MEPs under the Code, and are not materially affected by the DOL's past or present stance on open MEPs—different regulators, different governing statutes.

effect that such plans must file a separate Form 5500 (with separate audit, if the employer is a large plan filer[3]) and have its own ERISA bond. One way of looking at the existing 2012 guidance is therefore that it levied compliance requirements on open MEPs that add burdens and discourage adoption of new MEPs.

In contrast, the term "closed" MEP therefore grew up to describe a MEP that is not "open"—meaning the closed MEP meets the DOL's 2012 criteria for single plan status under ERISA, and therefore files only a single 5500 (with single audit) for the entire MEP, and has only one ERISA bond for the entire MEP.

These terms can create confusion, but they are useful. An open MEP today requires separate 5500, audit, and bond for each adopting employer under the DOL's 2012 guidance. A closed MEP files a single 5500 with a single audit, and has a single bond. Under the 2012 rules, relatively few associations or groups of employers could safely sponsor a MEP and have it treated as a single ERISA plan (closed). **The effect of the ARP final rules is that a much larger number of groups or associations of employers can now sponsor closed MEPs**.

Expanding Access to "Closed" MEPs

The ARP final rule ("Rule") takes a plan type that has been around for many decades—MEPs—and expands access to that plan type. ARPs are therefore not a new type of plan. They are a new pathway to an old type of plan. To summarize the regulatory history:

- **MEPs Predate ERISA and the Code**. MEPs have been around since at least the 1930s, before the modern Code and ERISA[4]. Laws and regulations therefore wrapped themselves around these constructs over time, with each statute and regulator looking at them in different ways. A point worth clarifying, since there is widespread confusion about it, is that there is no law or regulation that says, "Here's what a MEP is, and here is the only way you can start one." Instead, generally speaking, the legal system recognizes the ability of employers to band together under a single plan document and fiduciary to operate a plan for their employees, and the debate is over how such plans must be operated, not whether they can exist.
- **Fewer Groups or Associations Can Sponsor "Closed" MEPs under 2012 Rules**. In order to create a "closed" MEP (one that is a single plan for both ERISA and tax code purposes, and therefore files a single 5500 with a single audit), the 2012 DOL rules established a fairly narrow fact pattern—not many groups or associations could qualify as an "employer" and thereby sponsor a closed MEP. For example, a chamber of commerce could not establish a closed MEP under the existing (2012) rules, but will be able to do so under the new rules.
- **More Groups and Associations Can Sponsor MEPs under the New Rules**. Local chambers of commerce, members of the same trade or line of business, PEOs, and businesses in the same state or city can band together to form closed MEPs under the new rules.
- **Clarity for PEO MEPs**. A plain reading of the 2012 DOL rules might suggest that PEOs (Professional Employer Organizations) can't sponsor closed MEPs. Yet PEOs have been sponsoring closed MEPs since 2003 due to IRS guidance[5] more or less requiring them to do so, and the PEO industry was therefore concerned about the 2012 guidance. The final regulation clears this up: PEOs, as defined by the regulation, can sponsor closed MEPs.

[3] A large plan filer is required to file the full Form 5500 (may not use the short form); organizations with 100+ "eligible employees" (as defined by DOL regulations) are large plan filers.
[4] The Employee Retirement Income Security Act of 1974, as amended
[5] Revenue Procedure 2002-21, which mandated that PEOs sponsoring plans in which client employers participated must convert those plans to MEPs, or break them apart.

ARPs vs. PEPs

Much of the buzz in the industry and in Washington these days is around the SECURE[6] Act and its Senate predecessor, RESA[7]. SECURE passed in the House almost unanimously, but is currently stalled in the Senate. SECURE would give us Pooled Employer Plans, or PEPs. PEPs would create a pathway for expanding closed MEP benefits (single 5500/audit and bond, as well as other MEP benefits like pooled negotiating power and risk reduction) to open MEPs that can be sponsored by service providers. Looked at another way, PEPs are open MEPs (available to anyone) that could start acting like closed MEPs (single 5500/audit and bond), and virtually anyone could start one.

The major difference between ARPs and PEPs, other than the "open" part, is who can sponsor them. PEPs, under the current form of the proposed legislation, can be sponsored by financial institutions directly. ARPs are simply a form of ERISA plan like any other, and must be sponsored by an employer, as defined by ERISA Section 3(5).

It is the inability of service providers such as recordkeepers to act as employers that keeps them from sponsoring MEPs. Part of the reason for this is ERISA's conflict of interest rules. If a recordkeeper sponsors a MEP/PEP, in which it is the only recordkeeper, there is a conflict of interest under ERISA. The point of RESA and SECURE, therefore, is to establish a statute with accompanying DOL guidance that allows financial institutions and other service providers to be sponsors, and to get paid for the services they provide despite the conflicts of interest. If SECURE passes, therefore, the DOL will need to publish prohibited transaction exemptions and/or other guidance before the PEP structure will be ready for use, generally speaking.

ARPs, by contrast, are simply a new pathway to an existing structure. The sponsors cannot be financial institutions or service providers (except for PEOs, which are a special case), so there is no prohibited transaction or conflict of interest under ERISA inherent in the structure. It is therefore within the DOL's power to publish these regulations and move ARPs forward, whereas legislation is needed for PEPs.

To summarize, the goal of PEPs from a policy standpoint is to allow service providers to sponsor open MEPs, in hopes that this will promote broader coverage (i.e., more retirement plans). ARPs have the same policy goal—broader coverage—but do not allow service providers to sponsor them. ARPs are sponsored, instead, by a group or association of actual employers, or by a PEO.

ARPs and PEPs are MEPs—A Word about Terminology

Association Retirement Plan is simply a descriptive term—the structure is a MEP. PEPs, on the other hand, have specific requirements that make them different from current MEPs or new MEPs that might get created under the ARP rules. But PEPs are still MEPs—they just have extra rules to follow.

Summary of the ARP Final Rule

What follows is a summary of the Rule that preserves the exact numbering but summarizes and highlights the text for brevity and clarity. Click here for the full text (the Rule is found on the last 7-8 pages of 135).
2510.3–55 Definition of Employer— Association Retirement Plans and Other Multiple Employer Pension Benefit Plans.

[6] Setting Every Community Up for Retirement Enhancement Act
[7] Retirement Enhancement and Savings Act

(a) **In general**. The purpose of this Rule is to clarify which persons may act as an ''employer'' within the meaning of section 3(5) of ERISA in sponsoring a multiple employer defined contribution pension plan

(b) ("MEP"). A "bona fide group or association of employers" and a "bona fide professional employer organization" who meet the requirements below are considered "employers" under ERISA and may sponsor MEPs.

(b)

(1) **Bona fide group or association of employers**. Requirements:

(i) **Primary purpose** and **substantial business purpose**. The primary purpose of the group or association may be providing a MEP but there must also be at least one substantial business purpose unrelated to offering the MEP or other employee benefits.

As a safe harbor, a substantial business purpose is considered to exist if the group or association would be a **viable entity** in the absence of sponsoring an employee benefit plan. For purposes of this paragraph (b)(1)(i), 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;

(ii) **Members only**. Participating employers must be group/association members and must have at least one employee participating in the MEP.

(iii) **Governance structure**. The group or association has a formal organizational structure with a governing body and has by-laws or other similar indications of formality;

(iv) **Control**. The functions and activities of the group or association are controlled by its employer members, and the group's or association's employer members that participate in the plan control the plan. Control must be present both **in form and in substance**;

(v) The employer members have a **commonality of interest** as described in paragraph (b)(2);

(vi) **For member employees and former employees only**—no non-member participation in the MEP is allowed (though former employees and beneficiaries of members or former members are allowed to keep assets in the plan); and

(vii) **Financial institutions and service providers do not qualify as "employers."** The group or association is not a bank or trust company, insurance issuer, broker dealer, or other similar financial services firm (including a pension recordkeeper or third-party administrator), or owned or controlled by such an entity or any subsidiary or affiliate of such an entity, other than to the extent such an entity, subsidiary or affiliate participates in the group or association in its capacity as an employer member of the group or association.

(2) **Commonality of interest**.

(i) Either:

(A) **Same line of business**. The employers are in the same trade, industry, line of business or profession; or

(B) **Same region**. Each employer has a principal place of business in the same region that does not exceed the boundaries of a single State or a metropolitan area (even if the metropolitan area includes more than one State).

Note: this would seem to indicate that a general business association such as a chamber of commerce must be regional in order to sponsor a MEP.

(ii) An association sponsor can join the MEP (treated as being in same trade or business).

(c)

(1) **Bona fide professional employer organization**. A professional employer organization (PEO) is a human-resource company that contractually assumes certain employer responsibilities of its client employers. A bona fide PEO meets the following requirements:

(i) Performs **substantial employment functions** on behalf of its client employers that adopt the MEP, and maintains adequate records;
(ii) The PEO has **substantial control** over the MEP, as the plan sponsor, plan administrator and a named fiduciary, and is still responsible for former clients' MEP participants who remain in the MEP.
(iii) Each adopting employer must have **at least one MEP participant**; and
(iv) **Clients only**. Adopting employers must be PEO clients.

(2) **Safe harbor criteria for substantial employment functions**. This is determined on the basis of the facts and circumstances of the particular situation but with the following safe harbor:

(i) **Wages**. The PEO assumes responsibility for and pays wages to employees of its client employers that adopt the MEP, without regard to the receipt or adequacy of payment from those client employers;
(ii) **Taxes**. The PEO assumes responsibility for and reports, withholds, and pays any applicable federal employment taxes for its client employers that adopt the MEP, without regard to the receipt or adequacy of payment from those client employers;
(iii) **Recruiting, hiring, and firing**. The PEO plays a definite and contractually specified role in recruiting, hiring, and firing; and
(iv) **Employee benefits**. PEO has responsibility and substantial control over the employee benefits which the service contract may require the PEO to provide, without regard to the receipt or adequacy of payment from client employers for such benefits.

(d) Dual treatment of working owners as employers and employees.

(1) A **working owner** of a trade or business **without common law employees** may qualify as both an employer and as an employee for purposes of participating in a MEP other than a PEO MEP.
(2) The term "working owner" has a somewhat **complicated definition**, but is mostly self-explanatory.
(3) The MEP sponsor/administrator must **monitor** whether working owners continue to be eligible to participate.

(e) **Severability**. This is an interesting section that is designed to allow reliance on the regulations even if there are challenges from courts or other delays in implementation. It says what many contracts say—that if any one provision is found to be invalid, it doesn't invalidate other provisions.

The Ability for Working Owners to Join an ARP

The final rule makes clear that "working owners" can join ARPs. This is a complicated issue. To cut to the chase, making working owners eligible to participate in MEPs probably will not move the needle much on coverage of the self-employed, at least for now. Read on for details.

One of the policy talking points around MEPs in the past decade has been the desire to find an easy way to get the self-employed (those with no common law employees) into the private retirement system. The first use of the term "Pooled Employer Plan" was in President Obama's 2015 budget proposal, and that proposal also contained the first mention of the possibility of including the self-

employed in MEPs. Policy wonks probably drew, in part, on the history of the Superannuation or "Super" system in Australia[8] in crafting this proposal, since the inapplicability of Super to the self-employed was one of Australia's few remaining coverage gaps. Another major factor is the sheer number of self-employed: 15 million in the U.S. in 2016, of whom over 11 million have no employees[9], representing a large pool of uncovered workers.

One problem with making MEPs work for the self-employed is that the DOL is not the only regulator. One obstacle to including working owners in MEPs is that a working owner who sponsors (and, possibly, adopts) a retirement plan could be seen as having a "Keogh" plan. Keogh is an old term for what, today, is called a solo 401(k), or solo profit-sharing plan. The term itself is outdated, but securities law still considers such plans to exist. The reason this matters is that many collective investment funds (CIFs—bank trusteed funds that are not mutual funds, or "'40 Act funds") rely on the "Qualified Institutional Buyer" exemption[10] to allow special approaches to asset purchases and sales, and these investment managers will not risk losing their QIB exemption. This requires, among other things, that NONE of the assets of the fund be from Keoghs. Since CIFs (commonly referred to in the marketplace as "CITs" or collective investment trusts) are rising in popularity and can offer substantial cost benefits, the issue affects MEPs.

Another obstacle to including working owners is cost. From the perspective of a MEP administrator, an employer with a single participant is still an employer who needs service, and one-participant plans are not a great match for a MEP run by professional fiduciaries. One practical reason for this is that working owners can sponsor their own solo-k at low cost, and the solo-k is *not subject to ERISA*. So many of the burdens a MEP takes off of an employer actually don't apply to a working owner in the first place.

Finally, the final Rule requires the MEP sponsor or administrator to monitor working owners to ensure they remain eligible. This is an added administrative chore that is not easily automated at present.

The bottom line is that the "working owner" discussion has a noble policy purpose, but MEPs are probably not the best vehicle for covering self-employed business owners with no common law employees.

Will the ARP Regulations Stand?

ARPs are modeled in part on Association Health Plans (AHPs), which are a sort of MEP for health and welfare benefits. The DOL published AHP final regulations in June of 2018, and a coalition of eleven states' attorneys-general promptly filed a lawsuit, which succeeded in overturning the AHP rules in the D.C. circuit court in March of 2019[11]. The motivation for the lawsuit was that the AHP rules were seen as an attack on the Affordable Care Act (ACA). The significance of the case for ARPs is that the core of both the AHP and ARP final rules is the definition of "employer," and the court found the DOL's interpretation of ERISA to be "unreasonable" with respect to the AHP final rule's definition of "employer."

It will be interesting to see commentary from attorneys in the coming weeks over the precise changes to the wording of the final ARP rule, and whether they view those changes as sufficient to avoid a

[8] Australia's national retirement system includes a relatively small, means-tested Social Security-type benefit plus mandatory contributions to "Super," which is a system of individual accounts managed by private fund managers. Contributions by employers are mandatory

[9] U.S. Bureau of Labor Statistics, "Self-Employment in the United States," March 2016.

[10] SEC Rule 144A, which allows institutional buying and selling of assets

[11] *New York v. DOL*, March 28, 2019

challenge in court. The DOL has canny lawyers on staff, and it seems likely their choices were thoughtful. In particular, the addition of section (e) on severability seems designed to make the Rule more difficult to stop.

Absent a successful legal challenge, the ARP final rules go into effect sixty days after publication in the Federal Register, which is presumably September 30, 2019. Another interesting question is whether a "bona fide group or association" which establishes a MEP in reliance upon the new rules has much risk in doing so, even if there is eventually a court challenge.

"Not a Cost Play"

From the author's conversations with multiple retirement industry executives in 2018 and 2019 about MEP and PEP strategy, one comment stands out. An executive said that the media and Washington seem to think that MEPs and PEPs are all about making plans cheaper, but, "This is not a cost play." In other words, when you put professional fiduciaries atop a retirement plan and hold them accountable for a large group of employers, versus leaving fiduciary responsibilities with the employers, it costs more.

The MEP has purchasing power to negotiate the cost of the professional fiduciaries ***and the enhanced recordkeeping and administration services those fiduciaries will demand***, but the simple fact that the plan is fully and professionally outsourced means cost will not be the primary driver of product design—it will be, and must be, fiduciary compliance—getting it right. That said, the marketplace tends to get what it wants, and it wants cheap MEPs, so cost will play a significant role in new MEP launches.

MEPs are arguably, therefore, the simplest, safest, least burdensome way to offer a retirement plan, but not always the cheapest—at least, not for the foreseeable future. Perhaps this will change over time as MEPs grow.

Conclusion

There is pent-up demand for associations to sponsor multiple employer retirement plans, and the final regulations will increase activity across the country among associations, trade groups, chambers of commerce, PEOs, payroll companies, HR consultancies, and others. It remains to be seen whether PEPs will enter the scene at some future date, but ARPs, in the meantime, are a significant step toward broader usage of multiple employer plans.

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