Department of Labor Proposes Multiple Employer Plan Expansion

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AUTHORS: David Levine, Michael Kreps, Seth Perretta, Malcolm Slee, Brigen Winters

On October 22, 2018, the Department of Labor (the "Department") issued a proposed regulation ("Proposed Regulation") to facilitate and expand the availability of multiple employer defined contribution plans ("MEPs"). The Proposed Regulation – issued in response to President Trump's recent Executive Order – provides clarity regarding the types of "bona fide" groups or associations of employers and professional employer organizations ("PEOs") that are permitted to sponsor MEPs. The Proposed Regulation is similar in many material respects to the Department's recently finalized Association Health Plan regulation, and it retains many of the criteria set forth in that regulation as the basis for establishing whether an association is "bona fide" (*e.g.*, commonality and substantial business purpose requirements). Comments on the Proposed Regulation are due by December 24, 2018.

I. Background

Bipartisan consensus to liberalize existing rules under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), to allow unrelated employers to participate in MEPs has existed for several years. The often-stated goal of MEPs is to reduce costs and expand coverage by allowing employers to achieve economies of scale, but existing guidance from the Department takes the position that unrelated employers can only participate in a MEP if they share an economic nexus and commonality of interests unrelated to the retirement plan. In other words, the employers generally must have a connection to each other than mere participation in the plan. This existing guidance significantly limits the ability of associations and financial institutions to offer MEPs.

With the express purpose of liberalizing the MEP rules, President Trump signed Executive Order 12857 on September 3, 2018. The Executive Order directed the Department to consider issuing regulations or other guidance to make it easier for businesses, including those with non-traditional employment structures, to participate in Association Retirement Plans (the term the Executive Order uses to refer to

MEPs). The Executive Order further directed DOL to consider policies to expand access to retirement plans for part-time workers, sole proprietors, working owners, and other "entrepreneurial workers with non-traditional employer-employee relationships," including potentially allowing them to participate in MEPs.

The President further directed Treasury to consider whether to issue regulations and guidance related to MEPs. Such guidance could address the "one bad apple" rule under which one employer can put an entire MEP's tax qualification at risk by, for example, failing nondiscrimination testing. There is currently no guidance explicitly creating a roadmap for MEP sponsors to deal with such qualification problems, though some providers have developed and implemented procedures to address the issue. As noted below, we believe that such Treasury guidance will also be released in the near future.

II. Proposed Regulation

The Proposed Regulation would supersede the Department's prior MEP guidance and broaden the types of organizations that can sponsor MEPs. Specifically, it would clarify which types of organizations may qualify as "employers" as defined by ERISA section 3(5). The key provisions of the Proposed Regulation are summarized below.

A. Applicable Plans

The Proposed Regulation applies only to defined contribution plans, as that term is defined in section 3(34) of ERISA. Presumably, that term includes both 401(k) plans as well as ERISA-covered 403(b) plans. However, it does not apply to (i) MEPs that cover employees of related employers not in the same controlled group (referred to as "corporate MEPs") or (ii) "open" MEPs for which the participating employers have no relational nexus of commonality.

B. Bona Fide Groups or Associations of Employers

Under the Proposed Regulation, a "bona fide" group or association of employers may sponsor a MEP. To be considered bona fide, the group or association must –

- Have a formal organizational structure with a governing body and bylaws or other similar indications of formality;
- Be controlled, in form and substance, by its employer members, who also must control the MEP;
- Have at least one substantial business purpose unrelated to offering and providing employee benefits to its employer members, though the primary purpose of the association or group may be to offer and provide MEP coverage;
- Limit plan participation to employees and former employees of employer members and their beneficiaries;

- Have members with a commonality of interests, meaning the employers must be either (i) in the same trade industry, line of business, or profession or (ii) have a principal place of business within a region that does not exceed the boundaries of the same state or same metropolitan area;
- Ensure that each employer member acts directly as an employer for at least one employee participating in the MEP; and
- Not be a bank, trust company, insurance issuer, broker-dealer, or other similar financial services firm (including recordkeepers and third party administrators) or an entity owned or controlled by such a financial services firm.

If finalized without change, the substantial business purpose requirement, the commonality requirement, and the prohibition on financial services firms acting as bona fide groups or associations of employers will materially limit the expansion of MEPs under the rules.

C. Bona Fide PEOs

Under the Proposed Regulation, a "bona fide" PEO (*i.e.,* a human resource company that contractually assumes certain employer responsibilities of its client employers) also may sponsor a MEP. To be considered "bona fide," a PEO must –

- Perform substantial employment functions on behalf of the client employers;
- Have substantial control over the functions and activities of the MEP and assume responsibility for the MEP as plan sponsor (under ERISA section 3(16)(A)), named fiduciary (under ERISA section 402), and plan administrator (under ERISA section 3(16)(A), and (iii));
- Ensure that each client employer that adopts the MEP acts directly as an employer of at least one employee who is a participant covered by the MEP; and
- Ensure that participation in the MEP is available only to employees and former employees of the PEO and client employers and their beneficiaries.

The determination of whether the PEO performs "substantial employment functions" is based on the relevant facts and circumstances. However, the Proposed Regulation lists the following nine criteria, which may be indicative of a substantial employment function:

- Payment of wages;
- Reporting, withholding, and paying federal employment taxes;
- Recruiting, hiring, and firing workers;
- Establishing employment policies, conditions of employment, and supervising employees;
- Determining employee compensation;
- Providing workers' compensation coverage as required by state law;

- Performing integral human resources functions (*e.g.*, job description development, background screening, drug testing, employee handbook preparation, performance review, paid time off tracking, employee grievances, or exit interviews);
- Performing regulatory compliance in the areas of workplace discrimination, family and medical leave, citizenship or immigration status, workplace safety and health, or permanent labor certification programs; and
- Continuing to have employee benefit plan obligations to participants after the client employer no longer contracts with the organization.

The Department specifies that PEOs need not meet all of the criteria. Rather, meeting a single criterion may be sufficient to demonstrate a substantial employment function where, for example, the PEO controls the manner and means by which employees accomplish their assigned chores or complete their assignments. However, the Department will not consider a PEO to have met the test where, for example, it only performs drug testing.

In order to provide more certainty with respect to the substantial employment functions test, the Department has proposed two safe harbors. The first is for PEOs that are licensed as certified professional employer organizations ("CPEOs") within the meaning of Internal Revenue Code ("Code") section 7705. A CPEO will be considered a "bona fide" PEO where it (i) has a service contract (within the meaning of Code section 7705(e)(2)) with participating employers, (ii) is responsible for the payment of wages to employees of client-employers, (iii) is responsible for reporting, withholding, and paying any applicable employment taxes, (iv) is responsible for recruiting, hiring, and firing workers, and (v) meets at least two of the other substantial employment function criteria. The second safe harbor permits a PEO not licensed as a CPEO to be considered "bona fide" where the PEO meets five of the nine substantial employment function criteria.

The Department's decision to include PEO-specific provisions in the Proposed Regulation was unexpected. It is a major departure from the Association Health Plan rule in which the Department specifically decided not to address PEOs.

D. Working Owners

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

E. Fiduciary Responsibility

Although not expressly discussed in the proposed regulatory text, the preamble to the Proposed Regulation makes it clear that, unlike some of the legislation introduced in Congress, employers participating in a MEP would retain some fiduciary responsibility for choosing and monitoring the arrangement and forwarding required contributions. MEP sponsors would generally be responsible, as plan administrator, for compliance with the requirements of Title I of ERISA, including reporting, disclosure, and fiduciary obligations. They would also be permitted (or in the case of PEOs, required) to act as the plan administrator (under ERISA section 3(16)) or a named fiduciary (under ERISA section 402).

The Department opined that MEP sponsors must be neutral and fair, dealing impartially with the participating employers and their employees and taking into account any differing interests. For example, when negotiating investment fees, the fiduciary should ensure that any fee reductions are allocated among participants in an evenhanded manner, regardless of the size of the employer. The Department would have "serious concerns" if a fiduciary were to treat participating employers and their employees differently without a reasonable and equitable basis.

F. Employment Status

The Department was careful to state in the preamble that nothing in the Proposed Regulation affects whether a sponsoring entity is a "joint employer" of the participating employees. The Department also clarified that the Proposed Regulation should not be read to state that businesses that contract with individuals as independent contractors become employers of the independent contractors merely because both the business and the independent contractors (as working owners) participate in the same MEP.

G. Impact on State-run MEPs

A number of states (*e.g.*, Vermont and Massachusetts) and localities are implementing or considering establishing MEPs for in-state employers. In 2015, the Department issued Interpretive Bulletin 2015-02 ("IB") to provide guidance on the application of ERISA to those plans. The IB provides that states can establish MEPs because the participating employers have a nexus by virtue of the fact that the state is tied to the contributing employers and their employees by a special representational interest in the health and welfare of its citizens. The Proposed Regulation does not explicitly reference the IB, though it would "supersede subregulatory interpretative rulings under ERISA section 3(5)." Thus, the impact of the Proposed Regulation on state-run MEPs is unclear.

III. Request for Comments

The comment period for the Proposed Regulation ends on December 24, 2018. The Department expressly requested comments on the following issues:

- All aspects of the Proposed Regulation, including its scope, as well as any data, studies, or other information that would help refine and improve the proposal's estimated costs, benefits, and transfers;
- Whether the final rule should address other MEPs not specifically addressed in the proposal (*i.e.,* corporate MEPs and open MEPs);
- Whether the Department should address other types of entities that should be treated as an "employer," within the meaning of ERISA section 3(5), for purposes of sponsoring a MEP;
- Concerns or issues related to joint employment status;
- Whether nondiscrimination provisions, similar to those in the Association Health Plan rule, are necessary, particularly where the plan provides a lifetime income feature;
- Whether a "working owner" who is not a common law employee could fail to meet the requirements of Code section 401(c), which requires a self-employed individual must have earned income in order to participate in a qualified retirement plan;
- Whether there are any circumstances under which working owners without employees should be able to participate in a MEP through a PEO;
- Whether additional or different regulatory amendments should be made to confirm or clarify the exclusion from ERISA of solo 401(k) plans (i.e. plans sponsored by working owners without employees), given the Proposed Regulation would permit working owners to participate in ERISA-covered MEPs;
- The Interaction of the Proposed Regulation with other federal laws, including Code section 413(c), which sets forth certain existing tax qualification rules for MEPs;
- The extent to which grandfathering rules or transitional assistance or guidance might be advisable;
- Whether any notice or reporting requirements are needed to ensure participants and the public have adequate information;
- Data, studies or other information that would help estimate the benefits, costs, and transfers of the Proposed Regulation; and
- Whether additional guidance or clarification is needed on the application of the principle that employers may only be treated differently if there is a reasonable and equitable basis to do so, particularly with respect to MEP administration (*e.g.,* investment management, recordkeeping, and allocating plan costs and expenses).

IV. Prospects and Pending Legislation

The Proposed Regulation is a priority for the Administration, so it is likely that the Department will issue a final regulation early in 2019. In that regard, it only took the Department five-and-a-half months to finalize the Association Health Plans regulation, which is substantially similar to the Proposed Regulation. It is also likely that the Treasury Department and the Internal Revenue Service will issue proposed guidance regarding MEP-related tax qualification issues in the near future.

It is worth noting that the Department's Association Health Plan rule is currently being challenged in court by a dozen attorneys general in the U.S District Court for the District of Columbia. The plaintiffs are challenging both the liberalization of the commonality requirements and provision allowing sole proprietors to participate in Association Health Plans. That litigation could have an impact on any final MEP regulation.

There is a material chance that Congress preempts the Department's rulemaking process by passing MEP-related legislation. There are a number of bills in Congress that would permit the use of open MEPs. Most notably, the Retirement Enhancement and Savings Act (H.R. 5282, S. 2526) – which cleared the Senate Finance Committee in 2016 on a unanimous vote – and the Family Savings Act (H.R. 6757) – which passed the House on September 27, 2018 – both contain provisions intended to expand the use of open MEPs. Those bills are significantly broader in scope than the Proposed Regulation and would require neither commonality nor a substantial business purpose.