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ERISA Update

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Pooled Employer Plans: Opportunities for Advisers

When Congress passed the legislation that included the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act), it amended the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code of 1986 (Code) to allow for a new retirement plan called a "pooled employer plan" (PEP). A PEP offers registered investment advisers (Advisers), broker-dealers, and other financial services providers the opportunity to offer a single plan to any number of employers who wish to join the PEP. As such, these assets can be pooled for purposes of providing retirement benefits, managing plan assets, and providing plan-related services. A pooled plan provider could have offered a PEP as early as January 1, 2021. At this point, Advisers and other financial services companies are trying to figure out the role they will play in offering PEPs and PEP-related services. The purpose of this column is to provide an update on the law as it affects PEPs and to help Advisers and other financial service providers determine how they might play a role in the PEP marketplace.

Overview of PEPs

The SECURE Act added Section 413(e) to the Code and Section 3(43) of ERISA, which allow for the creation of PEPs. A PEP is a defined contribution retirement plan that is qualified for tax purposes under Section 401(a) of the Code where (1) the plan is maintained by two or more employers that do not have a common interest other than adoption of the plan; (2) the plan provides retirement benefits to the employees of such employers; (3) the plan has a "pooled plan provider" (PPP); and (4) certain other conditions are met. Such other conditions are found in both ERISA and the Code.

Section 413(e) of the Code provides that each employer in the PEP is not responsible for the actions of any other participating employer that may result in the PEP losing its tax qualified status under Section 401(a) of the Code. In other words, the entire plan will not be disqualified merely because one or more employers are "bad actors." Only the "bad actor" participating employer or employers will be held liable for actions that jeopardize the tax-favored status of the plan. However, in order for the plan to be a PEP, the Code requires that the terms of the plan provide that if a participating employer fails to meet its responsibilities with regard to maintaining the PEP's tax-qualified status, the portion of the PEP attributable to the participating employer must be (1) spun-off to a single employer plan sponsored by such employer or (2) transfer the participant accounts attributable to such employer to individual retirement accounts (IRAs) established on behalf of such participants.

ERISA also includes additional conditions in order for a plan to be a PEP. Section 3(43) of

ERISA requires that the PPP (discussed in more detail below) be a "named fiduciary" of the plan. Furthermore, the plan must

> designate one or more trustees meeting the requirements of Section 408(a)(2) of the [Code] (other than an employer in the plan) responsible for collecting contributions to, and holding the assets of, the plan and require such trustees to implement written contribution collection procedures that are reasonable, diligent and systematic.

Such trustee meets the requirements of Section 408(a)(2) if the trustee is a "bank" as such term is defined in 408(n) of the Code, which includes among other things national banks and state-chartered banks and trust companies, or is otherwise approved by the Internal Revenue Service (IRS) to be an IRA custodian. The PEP also must provide that the participating employers and participants "are not subject to unreasonable restrictions, fees, or penalties with regard to ceasing participation, receiving distributions, or otherwise transferring assets of the plan…"

In addition to the above, ERISA requires that participating employers retain certain fiduciary responsibilities under ERISA. First, the employer is responsible for complying with ERISA's fiduciary duty provisions in selecting the PPP and monitoring the performance of the PPP. This duty also extends to any other party, other than the PPP, who is designated as a "named fiduciary" under the PEP. Second, the employer is responsible for "the investment and management of the portion of the plan's assets attributable to the employees of the employer (or beneficiaries of such employees)" except to the extent such investment management has been delegated by the PPP to another fiduciary. Finally, ERISA provides that the participating employer is the plan sponsor with regard to the portion of the plan attributable to its employee participants "except with respect to the administrative duties of the [PPP] describe in paragraph (44)(A)(i)." As discussed below, ERISA Section (44)(A)(i) provides for the PPP assuming substantial plan administrator, as such term is defined in Section 3(16) of ERISA, responsibilities.

Advantage of a PEP

The PEP is substantially different from pre-SECURE Act multiple employer plans (MEPs). The ability to create a PEP opens up opportunities to Advisers, broker-dealers and other financial services providers.

We discuss MEPs in some detail in the July 2019 issue of *The Investment Lawyer.* MEPs generally fall into two categories, "corporate" MEPs and "association" MEPs. In order to be treated as a single plan for purposes of ERISA, the participating employers in the MEP should have some common interest among the participating employers other than the adoption of the plan. Such interests may be some level of common ownership or control that is significant enough for the employers to be considered a single employer for purposes of ERISA and the Code. Or, such interests could be membership in an association, the primary purpose of which is something other than the provision of employee benefits. One key advantage of such MEPs is that the MEP is treated as a single plan under ERISA. This can create certain administrative efficiencies such as a single plan audit and a single Form 5500 filing. Additionally, the MEP can be structured so that a great deal of fiduciary liability associated with the MEP may be transferred from the participating employer to the party designated by the MEP as the party responsible for investment selection, for example, the named fiduciary or an investment manager designated by the named fiduciary, and as the plan administrator named in the plan.

From the perspectives of Advisers and other parties wishing to pool assets of various employers for purposes of providing retirement plan benefits, the shortcoming of a MEP is that the relationship among the participating employers must be something *other* *than* the provision of benefits. PEPs, on the other hand, *can only* be set up for the purpose of providing retirement benefits to employers that have no such relationships. The only link among them is participation in the PEP. As a result, the PEP opens up the possibility to Advisers and other financial services companies to make available a single plan to many different, disconnected employers in a way that was not possible before the SECURE Act. The PEP is treated as a single plan for purposes of ERISA. Plus, to the extent allowed under ERISA and the Code, the PPP and other parties can assume responsibilities and other liabilities for which participating employers might otherwise be responsible, which could make PEPs attractive to employers.

Role of the PPP

At the center of a plan intended to be a PEP is the pooled plan provider or PPP. As discussed below, the PPP plays a substantial role in the PEP. Moreover, the PPP assumes a significant amount of the liability associated with operating the PEP.

Both Section 413(e)(3)(A) of the Code and Section 3(44) of ERISA define the term "pooled plan provider" and explain the responsibilities the PPP must assume. Section 413(e)(3)(A) of the Code provides that the PPP must be designated by the terms of the plan as the "named fiduciary" and the "plan administrator" of the plan. The PPP must affirmatively accept such designation. Furthermore, the plan must provide that the PPP is responsible for performing all administrative duties that "are reasonably necessary to assure that" the plan complies with ERISA and Section 401(a) of the Code, that is, the tax qualification provisions, and that the participating employers take such actions to allow the plan to comply with ERISA and the Code.

Both the Code and ERISA require that the PPP register with the Department of Labor (DOL) and the Department of Treasury, which is discussed below. The PPP also is "responsible for ensuring that all persons who handle assets of, or who are fiduciaries of, the plan are bonded in accordance with Section 412 of [ERISA]." Finally, the PPP does not have to be a single person or entity. Both the Code and ERISA allow for aggregation when determining whether the PPP requirements are met. More specifically, the statutes provide that

> in determining whether a person meets the requirements of this paragraph to be a pooled plan provider with respect to any plan, all persons who perform services for the plan and who are treated as a single employer under subsection (b), (c), (m), or (o) of section 414 shall be treated as one person.

Therefore, a group of affiliated companies can together provide the services necessary to be a PPP.

Importantly, a PEP is an ERISA-covered retirement plan intended to be tax-qualified under Section 401(a) of the Code. Thus, the PPP should not only be concerned with making sure the plan meets the PEP requirements discussed in this article, but also the PPP must also assure that the PEP meets all of the ERISA and Code requirements that apply to ERISA-covered, tax qualified retirement plans. This includes operational details such as sending out required notices, submitting required governmental filings, enlisting independent public accountants to conduct audits, performing nondiscrimination testing, and a whole host of others. Furthermore, the PPP must assure that it complies with ERISA's fiduciary duty provisions and ERISA's and the Code's prohibited transactions. With regard to the latter, the PPP should carefully review how and how much it and plan service providers are compensated. Prohibited transaction compliance risks may be particularly acute with regard to compensation paid to the PPP or parties in which the PPP has an interest.

PEP Registration Requirements

As discussed, both the Code and ERISA require a PPP to register with the DOL. On November

16, 2020, the DOL issued a Final Rule entitled *Registration Requirements for Pooled Plan Providers*, 85 Fed. Reg. 72934 (Nov. 16, 2020). The Final Rule creates a new Form PR that PPPs are required to file at least 30 days before the PPP "begins operations." In addition to this initial filing, the DOL will require supplemental filings upon the occurrence of specific reportable events. PPPs must submit Form PR electronically through the DOL's electronic filing system.

As noted, the DOL stated that Form PR must be submitted at least 30 days before a PPP begins operations. The Final Rule defines "begins operations" as the earlier of (1) when the first employer executes or adopts a participation, subscription, or similar agreement for the plan specifying that it is a PEP, or (2) when the trustee of the plan first holds any assets in trust. The Final Rule also provided a transition period for PEPs intended to be operational in January of 2021.

The Final Rule provides that the PPP must disclose substantial information to the DOL in its initial filing and in supplemental filings. In the initial filing, such information includes, among other things: (1) identifying information; (2) points of contact; (3) identification of the administrative, investment, and fiduciary services that will be offered or provided by the PPP or the PPP's affiliates to the PEP; and (4) statements regarding certain ongoing federal or state criminal, civil or administrative proceedings and certain federal or state criminal convictions.

The PPP also must submit supplemental filings within 30 days after the end of the quarter in which a "reportable event" occurs or 45 days after a reportable event. Reportable events include: (1) any change in the information required in an initial filing; (2) any significant change in corporate or business structure of the PPP or an affiliate of the PPP that provides services to a PEP; (3) receipt of written notice of the initiation of certain administrative proceedings or civil enforcement action; (4) receipt of written notice of a finding involving a claim of fraud or dishonesty with respect to any employee benefit plan, or involving the mismanagement of plan assets; and (5) receipt of written notice of the filing of any certain federal or state criminal charges.

The DOL states in the Final Rule that the purpose of Form PR and the supplemental filings is "to provide the Department with sufficient information about persons acting as pooled plan providers to engage in effective monitoring and oversight of this new type of ERISA-covered retirement plan" and to "assist employers performing due diligence in selecting and monitoring pooled employer plans." As with other ERISA-covered plans that are intended to be qualified under Section 401(a) of the Code, both the DOL and IRS have the authority to audit PEPs to assure compliance with the requirements of ERISA and the Code, respectively.

PPPs and service providers, whether or not serving as a fiduciary, should assume that the DOL will be reviewing the Form PRs and supplemental filings submitted to it. And, in the not-too-distant future, they should expect the Employee Benefits Security Administration's Office of Enforcement to begin investigating PEPs and PPPs in order to review compliance with ERISA. The IRS also may decide to conduct audits to assure compliance with Section 401(a) of the Code. Additionally, as a fiduciary, a PPP is vulnerable to lawsuits for breach of fiduciary duty brought by participants and their counsel in class action lawsuits. Indeed, we have seen prominent law firms that are known to file class action lawsuits against ERISA-covered plan fiduciaries to begin targeting MEPs. At some point, these firms could turn their attention to PEPs. This is not to say that compliance and litigation risks should discourage the creation of PEPs. Indeed, a number of PPPs have already filed Form PR and begun operations. However, these risks highlight the need to carefully and thoughtfully establish and operate PEPs in accordance with the PEP requirements and the more broadly applicable ERISA and Code requirements.

Considerations for Advisers and other Financial Services Companies

At bottom, PEPs offer an excellent opportunity to Advisers and other parties to provide retirement benefits to a large number of employers and their employees in a cost-efficient manner. The key consideration for such Advisers and other parties is what role they will play with regard to a PEP.

Clearly, the PPP is at the center of the PEP and assumes a substantial amount of legal responsibility and, possibly, may be subject to DOL and IRS scrutiny with regard to the operation of the PEP. Advisers who currently serve as fiduciaries to ERISA-covered plans by reason of providing investment advice or providing discretionary investment services may not be off-put by acting as a fiduciary in connection with the PEP. However, if they intend to serve as a PPP, they will assume fiduciary responsibility for a much broader range of services necessary to operate the PEP.

In some cases, Advisers or other financial services companies may not have the necessary expertise to provide the day-to-day operational and administrative services associated with running an ERISA-covered, tax-qualified plan. In other cases, such companies may not normally assume fiduciary responsibility when they provide services to ERISA-covered plans, although they may be an expert at providing one or more of the services, for example, recordkeeping necessary to operate an ERISA-covered retirement plan. For such companies, the assumption of fiduciary status may seem like an impediment to becoming a PPP. However, as discussed, the aggregation provisions in the Code and ERISA allow for the PPP to provide such services collectively in conjunction with affiliates. Furthermore, there does not appear to be any limit to a PPP hiring third party service providers to aid it in operating the plan. That is exactly what sponsors of single employer plans do today when, for example, they hire Advisers and recordkeepers.

In some cases, an Adviser may not want to be a PPP. However, it may want to provide investment advisory services to an unrelated PPP or on behalf of the PPP. In those circumstances, it can partner with unrelated financial services companies that may be willing to assume PPP responsibilities. In any case, there are still a number of unanswered legal questions involving PEPs for which we await answers from the DOL and IRS. In the short term, there is sufficient authority under the PEP provisions of ERISA and the Code and long-standing legal authority under ERISA and the Code to address these issues. Both the Code and ERISA allow for good faith compliance in the absence of specific guidance. However, PPPs and service providers to PEPs should be prepared for possible changes as to how they run the PEP.

In summary, PEPs may prove to be an effective way to deliver retirement benefits to more US workers as intended by Congress. Further, PEPs will open up substantial business opportunities for Advisers and other financial services companies. Such companies should consider what role they may play in this "new world" of PEPs, how to implement that role, and the compliance and litigation risks associated therewith.

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