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Policy Brief

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Proposed Rule

Title: Definition of "Employer" under Section 3(5) of ERISA – Association Retirement Plans and Other Multiple-Employer Plans

Agency: Employee Benefits Security Administration, Department of Labor

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Summary

Proposed rule would change ERISA's definition of "employer" such that employer groups or associations can offer a MEP without a common trade or line of business so long as employers have a principal place of business within the same state or metropolitan area. The proposal also included the professional employer organization (PEO) as an entity that could sponsor a MEP. To do so, an MEP must provide substantial employment functions. PEOs can rely on 1 of 2 safe harbors to ensure the "substantial employment function" requirement is met. Working owners can qualify as both employer and employee for the purposes of participating in the MEP. "Open MEPs" are not addressed nor is the "one bad apple" rule.

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Department of Labor Issues Proposed Changes to Multiple Employer Plans (MEPs)

On August 31, 2018 President Trump issued Executive Order 13847, "Strengthening Retirement Security in America," which among other things called for the Secretary of Labor to explore policies that would expand access to retirement plans for American workers. The Executive Order specifically called out the policies surrounding the circumstances in which business owners could sponsor or adopt a Multiple Employer Plan ("MEP").

In lightning speed, the Department of Labor published its proposed rule less than 2 months later. The October 23rd release proposes to change the definition of "employer" under ERISA §3(5) in a manner that would make MEPs more widely available.

The proposed rule focuses on employer groups or associations and professional employer organizations ("PEOs"), clarifying when such groups, associations, or organizations may be treated as a single employer for the purposes of sponsoring a MEP.

What's a MEP and what was the DoL trying to Solve?

A MEP is an arrangement where different businesses adopt a *single* retirement plan. The public benefit of such an arrangement is that the employers, particularly small and medium sized businesses, can pool their resources to offer a retirement plan at a cost and level of risk that is not prohibitive. The DoL cites an alarmingly low retirement plan adoption rate for small businesses and seeks to address the barriers to plan adoption through a more widely available MEP structure.

In order for the employer, and thus the employees, to benefit from the MEP structure, the plan has to be treated as a *single* plan because economies of scale are lost when reporting, bonding and auditing must be replicated for each individual employer. However, if a group or association of employers do not fit ERISA's definition of "employer," the arrangement will be treated as a separate plan for each employer. Other concerns exist as to how provisions of Title I of ERISA could be satisfied under a multiple employer arrangement if ERISA did not recognize the arrangement as a single plan.

Subregulatory guidance put a harsh limit on the circumstances under which multiple employers can participate in a single MEP under ERISA. The current interpretation of ERISA's definition of "employer" requires groups or associations to have a connection with employers and employees in the plan beyond the provision of benefits. Consequently many multiple employer arrangements cannot constitute a single employer under ERISA even when it is recognized as a single employer under the IRC.

The DoL sought to fix the problem by relaxing the standards set forth in previous guidance and broadening the groups, associations and organizations that could be considered a single "employer" under §3(5) of ERISA. In doing so the DoL achieved more consistency with the tax code with respect to its treatment of MEPs.

Who can Establish a MEP under the Proposed Rule?

Groups and Associations of Employers

ERISA specifically calls out a group or association of employers in its definition of "employer." However the kinds of groups or associations that would qualify is restrictive. Under Advisory Opinion 2012-04A an employer group or association could only sponsor a MEP if *a sufficiently close economic or representational connection existed between the employers and employees that was unrelated to the provision of benefits*.

This meant that a bona fide group or association of employers had to be part of the same trade or business. Not surprisingly, few companies partnered with their fiercest competitors to offer retirement plans.

The DoL expanded the criteria for a bona fide group or association of employers that can establish a MEP. Under the proposed rule, a group or association is capable of establishing a MEP if:

a) It has at least one substantial business purpose unrelated to providing employee benefits

b) It has a formal organizational structure

c) A commonality of interest exists between its employer members (****Now includes common geographic location****)

d) Each employer member of the group directly employs at least one employee covered under the plan

e) The plan is only available to employees and former employees of the employer members

f) Its functions and activities are controlled by its employer members, including control of the plan

g) It is not a financial services firm (nor owned or controlled by one)

The most significant change in the proposal is the standard by which a group or association is determined to have a sufficient commonality of interest. Today, such a requirement means the employer members are of the same trade, industry, line of business or profession. The proposed rule would also include employers that have a principal place of business within the same state or metropolitan area. This will allow groups or associations of geographically related companies to band together for the express purpose of offering a MEP to their employees.

Professional Employer Organizations (PEO)

A PEO is a human-resource company that contractually assumes certain employer responsibilities of its client employers. While the PEO has been recognized as a MEP provider under the IRC, such organizations could not fit the definition of "employer" under the Department's current statutory interpretation of the term.

The DoL set forth criteria that would establish a PEO as an "employer" for establishing a MEP for its client employers. To do so, a PEO must:

a) Perform substantial employment functions on behalf of client employers (*see table for details*)
b) Have substantial control over the functions and activities of the MEP and assume certain statutory roles under ERISA
c) Ensure each client employer in the MEP has at least one employee who is covered under the plan.
d) Ensure participation in MEP is limited to current and former employees of the PEO and of client-employers

Items b, c, and d are not dissimilar from the criteria used for groups or associations. It is item **(a)** that really establishes whether an organization can sponsor a MEP as a bona fide PEO. The department lays out 3 paths to being a bona fide PEO that center around 9 employment functions. One path is a simple facts and circumstances determination while the other two are safe harbors that provide more certainty.

Substantial Employment Functions
Criteria for PEO

1. **Payment of wages to the employees without regard to the receipt or adequacy of payment from its client employers;**
2. **Reporting, withholding, and paying any applicable federal employment taxes, without regard to the receipt or adequacy of payment from its client employers;**
3. **Recruiting, hiring, and firing workers in addition to the client-employer's responsibility for recruiting, hiring, and firing workers;**
4. Establishing employment policies, conditions of employment, and supervising employees in addition to the client-employer's responsibility to perform these same functions;
5. Determining employee compensation, including method and amount, in addition to the client-employer's responsibility to determine employee compensation;
6. Providing workers' compensation coverage in satisfaction of applicable State law, without regard to the receipt or adequacy of payment from its client employers;
7. Integral human-resource functions, such as job description development, background screening, drug testing, employee-handbook preparation, performance review, paid time off tracking, employee grievances, or exit interviews, in addition to the client employer's responsibility to perform these same functions;
8. Regulatory compliance in the areas of workplace discrimination, family and medical leave, citizenship or immigration status, workplace safety and health, or permanent labor certification program, in addition to the client employer's responsibility for regulatory compliance; or
9. The organization continues to have employee benefit plan obligations to MEP participants after the client employer no longer contracts with the organization.

PEO Safe Harbor #1

Organization is a "Certified Professional Employer Organization" (CPEO)

AND

Has a service contract with client employers

AND

Satisfies facts and circumstances criteria 1, 2 & 3

AND

Satisfies at least 2 additional facts and circumstances criteria (items 4-9 above)

PEO Safe Harbor #2

Organization satisfies at least 5 out of the 9 facts and circumstances criteria above

How does the Proposal Affect Working Business Owners?

Working Owner:

- ☑ ownership right of any nature in the trade or business
- ☑ earns wages or self-employment income from the trade or business
- ☑ works at least 80 hours per month **or** earns wages or self-employment income over a certain amount

Trump's Executive Order also directed the Secretary of Labor to examine policies that would increase retirement security for part-time workers, sole proprietors, working owners, and other entrepreneurial workers with nontraditional employer-employee relationships. The proposal addressed the working owner by allowing them to be treated as both an employer and employee for a MEP established by an employer group or association but requires working owners to have at least one employee to participate in a MEP established by a PEO. The ability to be treated as both an employer and employee hinges on whether the owner fits the definition of "working owner."

What Does the Proposed Rule NOT Do?

The proposal does not allow for Open MEPs

The proposal falls short of opening the door to "open MEPs." In an open MEP, the employers have no relationship to each other beyond their participation in the MEP. This proposal only contemplates MEPs established by employer groups or associations and PEOs. The Department noted that legislation has recently been proposed that addresses the "open MEP" but seeks additional comment on how such an arrangement can fit within the statutory intent of ERISA for the benefits to be employment based.

The proposal does not relieve employers of ALL fiduciary responsibility

While much of the responsibility is shifted away from the employer in a MEP arrangement, employers are not entirely absolved of their fiduciary responsibility. Employers will obviously still be responsible for forwarding contributions to the MEP. Failure to do so may bring heavy consequences to the MEP and its other members. See "One Bad Apple Rule" below.

In addition to the contribution obligation, employers are responsible for prudently choosing the MEP arrangement. An employer cannot blindly participate in a MEP for its employees without applying a prudent process. In this sense, the obligation is no different than a plan sponsor's 408(b)(2) obligation to prudently select and monitor service providers. The ongoing duty to monitor the MEP is an obligation that should not be overlooked and should be provable by the employer.

The proposal does not change the "One Bad Apple" rule

One hurdle to MEP adoption could not be touched by the DoL because it's outside their authority. Treas. Reg. §1.413-2(a)(3)(iv), or lovingly referred to as the "one bad apple" rule puts the threat of disqualification on the entire MEP for the failure of just one MEP employer. The concerns contemplated by this rule are alleviated by prudent selection and monitoring of employers by the MEP. In a footnote, the Department indicated that the Treasury and IRS are actively considering if additional regulatory or other guidance would be beneficial. One would expect the Treasury to act on this in the not too distant future and remove this game-changing barrier to MEP adoption.

Will the Proposed Rule make MEPs an Attractive Option for Small Business Owners?

Overarching Consideration

As is the case with most regulatory relief, this proposal does not merely facilitate existing business practices nor does it provide a blueprint for a new business model. Instead, it removes certain barriers in order to achieve a public benefit.

The expectation is that businesses will use the relief to create profitable arrangements, in which those who seize the opportunity will be advantaged until such time as other slower adopters catch up.

The public benefit being sought is expanded preparedness for retirement. The relief being proposed makes it easier for employers to band together and thus provide more employees with access to a high quality retirement plan.

Industry Perspective

The public benefit will only be achieved if there is a way to increase the profitability of firms that are expected to market and deliver the MEP. The alignment of the public benefit and profitability requires a business strategy that departs significantly from current practices.

The business strategy requires two stages:

- Stage 1: Build Critical Mass
- Stage 2: Add Highly Profitable New Business

Stage 1 consolidates existing medium and small plans into MEPs, thus increasing the profit margins of the provider firms, expanding capacity and providing the economies of scale that will attract new business. These MEPs will offer “large plan features” to small businesses that do not compete with each other.

Stage 2 is a marketing focus that demonstrates the buyer benefits of the MEPs and adding new customers to MEPs at low incremental cost. The marketing focus is supported by presenting the value to an employee of an employer dollar paid as a contribution (~$1.50) versus the same dollar paid as direct compensation (~$0.75).

Key success factors for a firm offering MEPs include:

- Attractiveness to employees and potential employees
- Absence of competitive threat to employers
- Evidence of feature rich high quality plan
- Low burden on employer
- Low exposure to fiduciary liability
- Compelling case for employee continuity

While every firm will not adopt MEPs, those that do so will be able to take small plans away from non-adopting competitors as well as add large number of employers that currently have no retirement plan.