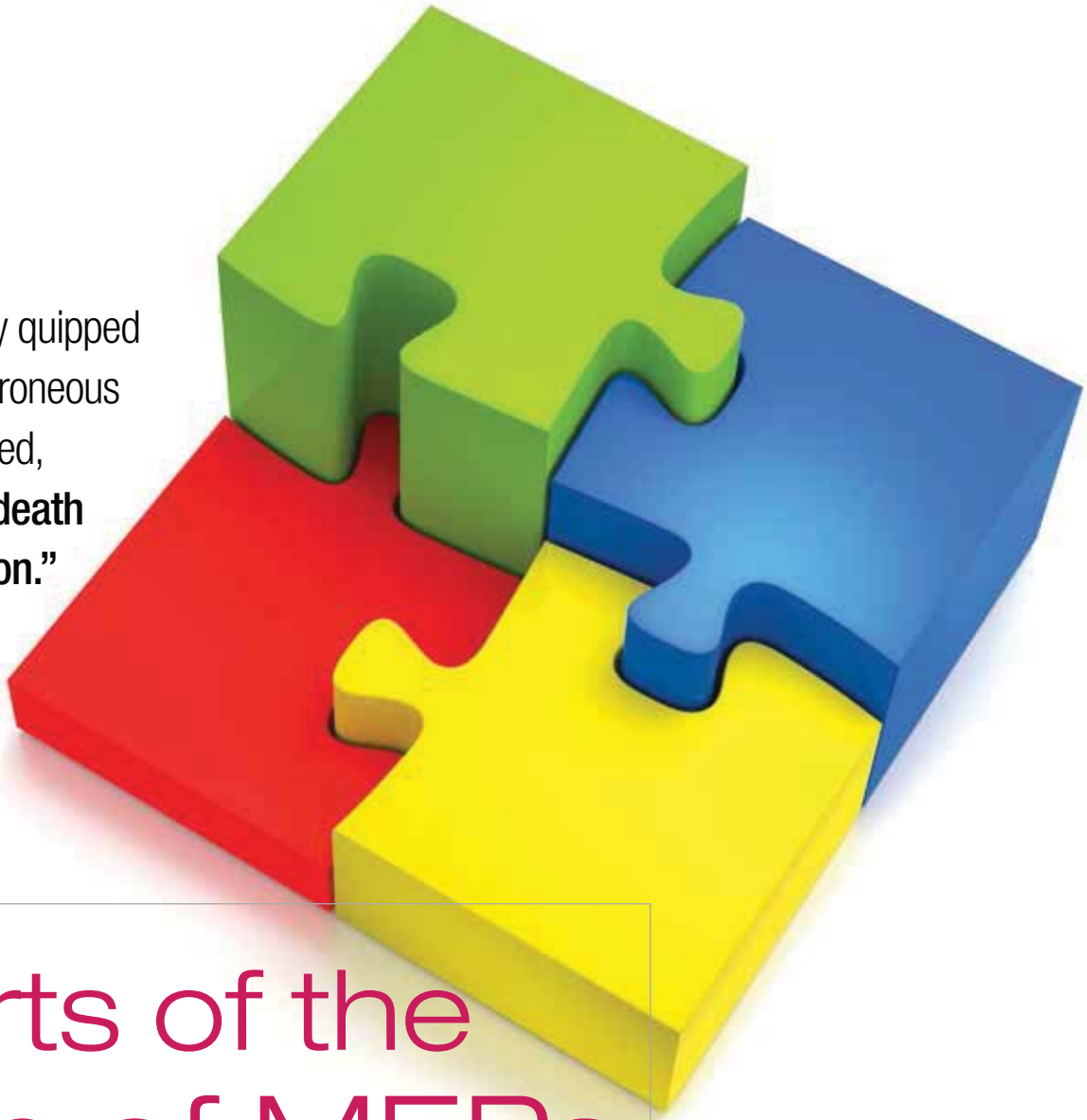
COMPLIANCE



Mark Twain famously quipped upon receiving an erroneous report that he had died, **"The report of my death was an exaggeration."** Today we could say the same of multiple employer plans.

Reports of the Death of MEPs Are Greatly Exaggerated

BY PETE SWISHER, CPC, QPA, TGPC

Multiple employer plans (MEPs) were all the rage for the past few years, until the DOL released Advisory Opinion 2012-04A, in which it clarified its stance that "open" MEPs (those open to any adopting employer rather than closed to a select group of employers) are not single plans under ERISA but are a collection of single plans for each adopting employer. The MEP rage has subsequently cooled, with sentiments like these being common:

- "We were taking a hard look at MEPs but now we've backed off because of the DOL's ruling."
- "We're holding off because of the uncertainty about where these are heading."

In addition to such feelings of uncertainty, some have voiced silly (or incorrect, at any rate) thoughts, like:

- "The DOL has shot down (or 'ruled against') MEPs."
- "MEPs are no longer allowed."

One of my favorites, from an ambitious broker speaking to an employer participating in a MEP (I paraphrase): "You need to consult a lawyer. The DOL has ruled that MEPs are illegal."

Nonsense. What the DOL did in AO 2012-04A was to clarify its stance with respect to the treatment of open MEPs for compliance purposes. The implication of the DOL's clarifying this stance is very simply that MEP fiduciaries must follow DOL's rules or risk DOL's wrath—exactly the same consequence as for 100% of the thousands of pages of laws and regulations affecting all ERISA plans.

MEPs will flourish for the simple reason that they have a compelling advantage over single employer plans: economy of scale. Almost everything you can do in a MEP you can do in a single employer plan, and in most cases there is flexibility in a single-employer plan that you cannot achieve in a MEP. But small plans need help—80% of plans are small plans,[1] and MEPs have the economy of scale to offer the sort of help that would otherwise be unaffordable to small plans. Thus, MEPs will flourish.

Naturally, however, saying something is so doesn't make it so. Therefore this article explores recent guidance and case law on MEPs and how service providers and employers can use the guidance to chart a safe path.

> "It's very common for a pension plan to have some data-related skeletons in the closet, and experienced pension administrators have seen it before."

SUMMARY OF THE IMPACT OF AO 2012-04A

Some practitioners thought open MEPs (those open to any adopting employer even though unaffiliated in any way) could be treated as single plans for ERISA purposes. The plain language of the law clearly supports this view: see ERISA §§3(5) and 3(16)(B) on page 34 and judge for yourself.

The DOL disagrees with this view. Open MEPs are not single plans in their eyes but are a collection of individual plans, which means each employer must satisfy ERISA individually.

As a practical matter this means just two changes to compliance procedures: (1) each employer must satisfy the Annual Report requirement (Form 5500, including the audit requirement for large plans) individually; and (2) fiduciaries must satisfy the bonding requirement with respect to each adopting employer, not just the overall plan.

STATUS OF OPEN MEPS AS SINGLE PLANS UNDER THE CODE

The IRS rules are different from the DOL rules. The Internal Revenue Code (the "Code") has Section 413(c) covering how MEPs are treated for Code purposes, and there are not and never have been any rules like those the DOL has put forth. An open MEP is still a MEP for Code purposes.

The DOL Advisory Opinion refers obliquely to this by saying, "The Department is not expressing any opinion in this letter on the application of section 413(c) of the Internal Revenue Code…"

So the DOL ruling changed the compliance requirements but did not "disallow" open MEPs or make them illegal. An open MEP is still a MEP under the Code, but for purposes of complying with the DOL's requirements it must be treated as a collection of single employer plans for DOL compliance purposes. As a practical matter the only major impact is cost: Open MEPs must do the added compliance work and pay for it.

THE NRECA SETTLEMENT

Of much greater interest than AO 2012-04A is a legal settlement that received much less publicity.

In a settlement agreement between the DOL and the National Rural Electric Cooperative

[1] Approximately 80% of filers of Form 5500 do not cross the threshold of the 100 participant rule of DOL Reg. §2520.103-1.

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Association (NRECA), the association agreed to restore $27.3 million to three MEPs—possibly the largest such judgment or settlement in ERISA history—for allegedly choosing itself as a service provider, setting its own compensation, and making payments to itself in excess of direct expenses.[2] As part of the DOL's ruling, it required the NRECA's MEPs to engage an independent fiduciary to approve the NRECA's services and compensation.

There isn't enough information from the DOL on the terms of the settlement to draw many conclusions, but one principle is obvious: MEP service providers must ensure that their governance structures provide that the authority for appointment and approval of compensation of service providers resides with a fiduciary who can be considered "independent." The employer fills this role in most single employer plans but MEPs must take care to ensure they meet the independence requirement. For more information on the DOL's view of the need for an independent fiduciary to approve service providers and their compensation, see DOL Reg. Sections 408b-2(e) and (f)(5).

THE GAO REPORT

On Sept. 13, 2012, the Government Accountability Office published a report on MEPs[3] that drew no conclusions but made several suggestions:

- DOL should lead an effort to collect data on the employers that participate in MEPs.
- DOL and IRS should formalize their coordination with regard to statutory interpretation efforts with respect to MEPs.
- DOL and IRS should jointly develop guidance on the establishment and operation of MEPs.

Of what significance is the GAO report? At present, not much. It simply alerts practitioners that the IRS and DOL, if they follow the GAO recommendations, may be embarking on a project to give joint clarification to MEP rules, a prospect that all parties mostly welcome.

WHY OPEN MEPS ARE SAFE

Open MEPs are safe for two reasons. First, the rules by which they must operate are known: They operate under IRS rules for MEPs in accordance with Code §413(c) and under the DOL rules for single employer plans under ERISA.

Open MEPs now know, if they did not already, that the DOL takes the position that open MEPs must meet the annual report and bonding requirements of ERISA §§102 and 412 as individual plans, at a modest additional cost over what a "closed" MEP would pay. Even with this additional cost the economies of scale make open MEPs an attractive alternative to single employer plans for employers who want help with plan management.

The second reason open MEPs are safe is conditional: As long as MEP documents and procedures allow for it, a MEP may be spun off into a group trust structure or into individual plans and trusts with minimal cost or hassle. Operationally there is no need for a recordkeeping conversion and the change is mostly just a paper shuffle. In other words there will always be options, so the MEP structure can reasonably be viewed as safe even for those prone to worry about what the regulators might think of next.

CLOSED MEPS AND THE 'BONA FIDE' REQUIREMENT

Advisory Opinion 2012-04A addressed the status of a particular "open" MEP, but it also clarified the conditions that the DOL uses to determine if a MEP is "closed" (*i.e.,* a single plan for ERISA purposes). The primary condition is that the plan must be maintained by a "bona fide" group or association of employers. The "bona fide" requirement is found nowhere in the statutes—it is found only in the DOL's interpretive guidance. The two main criteria for determining whether a group or association is "bona fide" are:

1. **Nexus.** There is an "organizational nexus," something that connects the members other than adoption of the plan, such as being part of a shared industry or a group of related companies.
2. **Control**. Adopting employers control the plan or group/association.

Here is a more complete list of factors the DOL considers, as specified in the

[2] See EBSA News Release Number 12-1335-PHI, July 5, 2012, at www.dol.gov.
[3] GAO-12-665.

Opinion but also found in previous guidance:[4]

- The manner in which members are solicited
- Who is eligible and who actually participates
- Nexus ("pre-existing relationship")
- Purpose and process for forming
- Powers of members by virtue of employer status
- Who is actually in control
- Participating employers exercise control in form and substance.

The NRECA got in trouble primarily because employers did not exercise control in form and substance according to the DOL; they were not "actually in control." The implication for current and future MEPs is that adopting employers must genuinely control the MEP; the MEP cannot be "owned" by a service provider or controlled by a service provider.

MAKING SENSE OF THE DOL'S POSITION

Here is the statutory language:

ERISA §3(5) THE TERM "EMPLOYER" means any person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan; and includes a group or association of employers acting for an employer in such capacity.

ERISA §3(16)(B) THE TERM "PLAN SPONSOR" means

(i) the employer in the case of an employee benefit plan established or maintained by a single employer;

(ii) the employee organization in the case of a plan established or maintained by an employee organization, or

(iii) in the case of a plan established or maintained by two or more employers or jointly by one or more employers and one or more employee organizations, the association, committee, joint board of trustees, or other similar group of representatives of the parties who establish or maintain the plan.

The plain language of the law would appear to support the interpretation that any group of employers, not any "bona fide" group of employers, may sponsor a plan and be treated as the employer for plan purposes. This is not meant to imply that the DOL is wrong to establish the "bona fide" requirement; clarifying how it plans to enforce laws is exactly what the Executive Branch is supposed to do. The problem is that the law itself is much less restrictive than the position taken by the DOL and the DOL's choice increases costs for participants. The question is whether that cost is justified.

The context for previous rulings has included fact patterns in which an implied motivation for the DOL was to protect participants in multiple employer plans run by service providers seeking an easy way to make product sales, often at the expense of participants. Creating the "bona fide" requirement was one mechanism whereby the DOL could curb some of the abuses it was seeing. If each adopting employer must have a Form 5500, audit and bond, then participants may be better protected. Deeming each adopting employer to be sponsoring an individual plan accomplishes this goal.

One could argue that the problem that needs solving is how to protect participants and that redefining the statutory language is not the best way to achieve this. Placing additional requirements on MEPs raises costs—and therefore burdens—to participants. In the absence of added protection for participants this money is wasted. But the DOL's position is what it is: The appropriate response is to do what it says, which is not difficult; it just costs more.

FUEL TO THE FIRE: THE HUTCHESON CASE

An example of the DOL's concern for the safety of participants in multiple employer arrangements is the 2012 case, *Solis v. Hutcheson*. In an excellent example of the need for dual controls and segregation of duties of the sort found in any regulated financial institution, an individual—via a limited liability company, but still an individual—had access to plan funds and stands accused of stealing some of them. The timing and nature of the *Hutcheson* case may have affected the timing and nature of AO 2012-04A and hardened the DOL's resolve with respect to its approach to the "bona fide" requirement as one solution to the problem of protections for participants.

THE TRUTH ABOUT MEP ECONOMIES OF SCALE

Do MEPs truly offer economy of scale? The GAO report inexplicably states that this is not clear, but even the most casual observer can see obvious economies simply by considering the daily workload of any service provider. For example:

1. Advisors who contemplate MEPs are attracted to the notion that the investment oversight process can be streamlined: one set of investments, one IPS, a single report, streamlined delivery.
2. Any TPA or record keeper can tell you that a block of plans using identical provisions is easier to administer than the same block of plans on different documents and platforms.
3. Most vendors charge a plan

[4] Rao, Jessica 'Bust of The Baby Boomer Economy: "Generation Spend" Tightens Belt', 2010 http://www.cnbc.com/id/34941331/Bust_of_the_Baby_Boomer_Economy_quotGeneration_Spendquot_Tightens_Belt.

document fee; with a MEP there is only one document so this fee goes away. When the document must be restated the IRS filing is reduced in scope. When the document is amended there is a single SMM.[5] When the SPD[6] is revised, there is only one SPD.

4. The employee education and communication process is simpler: one set of materials, one set of details to communicate, less time spent preparing for meetings.
5. For compliance specialists who just went through fee disclosure, imagine having a single 408(b)(2) or 404a-5 disclosure for a large number of clients. It's like paradise.
6. Any large plan employer recognizes the benefit of having a separate plan fiduciary handle the hiring of the auditor, overseeing the audit, and negotiating a favorable audit price through bulk purchasing power.
7. Imagine a hypothetical board of directors of an association that sponsors a MEP—whether open or closed—with just five adopting employers. Does this board have more or less negotiating power than each adopting employer has individually? What if there were 50 adopters?
8. Imagine that every employer is conscientious about mailing mandatory notices and disclosures to terminated participants (admittedly a bit far-fetched). Is it hard to imagine that a professional fiduciary doing a mailing for all terminated participants of a MEP simultaneously can do the job more reliably and less expensively than having each employer repeat the process?

This is just a sample. Choose any task that is required in a retirement plan and you will likely have an "Aha!" moment in which you can think of several ways to streamline the task when doing it for many employers simultaneously in a MEP. The notion that there are no economies of scale in a MEP is easily refuted with the most cursory analysis.

But there is a flipside: The economies of scale are modest. Those who are new to MEPs often begin with enthusiasm at the notion that one big plan can cut costs in half. Service providers who are MEP neophytes may even grant that sort of huge discount, not realizing what they're getting themselves into. The reality is that each employer still needs help and requires service.

Record keepers generally set up MEP adopters as separate plans on their systems; for all intents and purposes they are separate plans. Testing and contribution calculations are handled one employer at a time. Enrollment meetings, when conducted, must be conducted one employer at a time. The basic work of running the plan can be streamlined in a MEP but it cannot be eliminated.

In one sense MEPs require more work, not less. A professional fiduciary who is not suicidal (presumably the MEP fiduciary will be an expert, but this is not necessarily the case) will be vastly more conscientious about compliance than the typical employer, who is at best a rank amateur as a fiduciary and knows it. There is work that ought to be done in the typical plan that never gets done. In the MEP, it gets done or the MEP fiduciary is at significant risk. This costs more. The economies of scale make it possible to offset the cost of the added work, but the resulting total expense might be either higher or lower than the cost of a single employer plan with the employer as fiduciary.

MEPs offer modest but clear economies of scale, and the economies make it possible to pay professional fiduciaries.

THE FUTURE OF MEPS

Most plans are small plans and small plans have limited resources. MEPs—including open MEPs—therefore have the ability to fill an unmet need; they make expert fiduciary outsourcing possible at a reasonable price through genuine economies of scale. Serving as the professional fiduciary of an ERISA plan is a big step that puts a provider at risk and requires extensive processes and controls whether in a MEP or a single employer plan. If this is the service employers want and need, a MEP is a powerful tool for delivering it. Not all MEPs and MEP vendors will provide the same level of service and not all such arrangements will be cost effective, but this does not change the fact that the structure itself is fundamentally both sound and useful.

The recent guidance on MEPs leaves us with a message: govern well. MEPs have a bright future, but the brightness in the future of MEP promoters and fiduciaries may be the lights of an oncoming freight train—as NRECA learned—if they fail to create governance structures that regulators can approve. Fortunately, this is easy; the regulators have given us plenty of information to structure safe, effective programs that fulfill the MEP promise of professional governance at a reasonable price. PC

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[5] Summary of Material Modifications, a required notice to participants whenever there is a material amendment to the document.

[6] Summary Plan Description, the plain language (supposedly) summary of the plan document for participants.