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MEPs, PEPs and Payroll Plans: BUYERS BEWARE

The passage of the SECURE ACT allows for Pooled Employer Plans (PEP) and provides new rules for Multiple Employer Plans (MEPs) effective January 1, 2021. While these plans will tout simplicity and cost savings to small business owners, in my opinion these plans will not be the best for most clients and advisors. Here is why.

Under the old rules, MEPs had to have a “Commonality of Interest” among the employers. We saw these plans in trade associations and common ownership among businesses as a way to use one plan and save on administrative fees. MEPs are now easier to establish. In addition, the "one bad apple" rule, where the compliance failures of one employer could disqualify the entire plan, has been eliminated.

The SECURE Act created PEPs which do not require the “Commonality of Interest”. So many financial organizations are seeing this marketing opportunity as a low-cost alternative to the traditional “stand alone” plans that we are using today. PEPs are limited to 401(k) plans. Defined benefit plans, 403(b) plans, governmental 457(b) plans and multi-employer plans for collectively bargained employees are excluded from the new PEP provisions. Additionally, smaller MEPs and PEPs, with fewer than 1,000 participants, are exempt from a potentially expensive audit requirement, if no one employer exceeds 100 participants.

Sounds like a good deal, but is it? On the pro side, they will tout lower costs because of no individual document or 5500. While this is something, it is nowhere near the costs of administering a plan. There is testing, enrollment, compliance and other issues that are involved in running a retirement plan. We will see what the actual fees are when they come to market. I can see this as an alternative for companies wanting only a safe harbor designed plan with no additional employer contributions. A true employee benefit plan.

On the con side, a client will give up an individually designed plan to a prototype document with few customizable elements. This means many contribution allocation methods and other provisions may not be available. If an employer wants to make profit sharing contribution and skew them to the owners’ favor, these plans, I believe will not fit. Further, traditional fees for setting up individually designed plans are $1,200-$1,500, so a few hundred-dollar savings is no way worth the flexibility to fund additional amounts for our business owners. We traditionally bring value by saving our clients money through proper plan design and flexibility. A small savings up front could cost clients thousands over the long term. For our sample proposal illustrating these savings, click here. For our fee schedule, click here.

I have heard of clients getting “hard sales” calls telling them they are required to adopt these plans or be forced use Cal Savers. In my opinion, should an employer not want to contribute anything for themselves and no company money for the employees, the California CalSavers Program has many advantages over a PEP. There is no document/installation fee, no investment liability as employers are merely required to set up an account and fund it entirely out of employees pay. No risk, no liability. Clearly, a PEP with no company money is not a superior option. For more on CalSavers, click here.

Perhaps the biggest con to PEPs is the fiduciary liability issues. First, the employer is not relieved of liability for their decision to use a PEP. They have a duty of due diligence in choosing and monitoring the administrative and investments and its providers. They will have the same administrative burdens of enrollment, education, payroll and employee contributions. If they are sold by a provider without expertise in these duties, their liability increases.

We have seen multiple problems in plans set up by payroll providers. While these companies are good at payroll, their lack of understanding and their greed are hurting clients when it comes to plan design and operation. The only real overlap is the payroll component. There is so much more to designing and running these plans. The so-called savings are nonexistence once these plans, service, investments and fees are revealed. I can see these “bad actors” jumping into the PEP game and hurting our industry even further.

Another big problem is risking your reputation, client relationships and lawsuits for financial advisors and providers who may want to offer these plans. Under current rules, there is an inherent conflict of interest when offering these investments. A “Request for Information” has been filed with the DOL asking for a clarification and perhaps an exemption for those offering these plans.

In addition, there appears to be a requirement that all PEP providers take on 3(38) co-fiduciary roles as way to handle this conflict of interest, but we shall see as these products come to market. For a full discussion on these various issues, click here.

There is also some talk of the Obama-era “Fiduciary BICE rule” making a return. This rule basically requires financial advisors to sign a contract stating they will be working in the “best interest” of the client. This will put the advisor on the hook as well for offering or recommending these plans to their clients. For more on BICE rule, click here. I have seen advisors lose clients for recommending subpar options for their retirement plan needs.

BOTTOM LINE: Be very careful offering these plans to your clients. Check your players and their expertise along with their time in the administration and provider markets. Be wary of those who are offering an ancillary to their regular business, like payroll providers or IRA companies. Check for the burden of education, enrollment, and other administrative duties. Review plan design options, all fees (stated and hidden), investments options and all accompanying fiduciary issues. Protect yourselves and your clients and give this market time to work itself out. Should these plans be a viable option, firms like ours will be offering them as an alternative to a stand-alone plan. I may be wrong in my analysis, but I do not think I am. Time will tell. And as always, we are here to help.

Thank you and stay safe!

The Marketing Team at NH Hicks