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Open Multiple Employer Plans: Tax and ERISA Considerations

A WHITE PAPER BY

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Introduction

Sponsors of 401(k) plans (and the company officials charged with the responsibility of managing them) have significant obligations under the Employee Retirement Income Security Act (ERISA).¹ Those duties include the prudent selection and monitoring of service providers and the investment options offered to the participants,² and they have been referred to as the highest duties known to the law.³ Expanding on these obligations, the Department of Labor (DOL) is in the process of finalizing new disclosure regulations that will require 401(k) plan fiduciaries to engage in a heightened level of review of service provider arrangements and to ensure that significantly enhanced disclosures related to investment options, fees and other subjects are being made to the participants.⁴ While some of these fiduciary duties may be delegated to others, the plan sponsor retains the ultimate responsibility – and potential liability if something goes wrong – for operating the plan in the best interests of the participants.

In light of these expanding regulatory requirements, plus increased 401(k) plan fee and fiduciary litigation, small and mid-sized employers — as well as their advisers — may be looking for options to provide their employees with the benefits of a well-managed 401(k) plan while reducing their administrative burdens and mitigating fiduciary risk. One approach that is gaining wider acceptance among both plan sponsors and their advisers is the “open” multiple employer 401(k) plan – a single plan sponsored by an independent plan sponsor that covers the employees of a number of unrelated employers, with a centralized administrative and fiduciary structure.

The concept of the multiple employer plan (MEP) is clearly established under both the Internal Revenue Code (the Code) and Title I of ERISA. In particular, and for reasons discussed in more detail later, MEPs have been commonly offered for years by Professional Employer Organizations (PEOs), which are employee-leasing organizations, to their employer-clients. MEPs are also commonly sponsored by organizations and associations of employers within certain industries. The distinction between an “Open MEP” and any other MEP is that an Open MEP is offered for adoption by any employer, whereas other types of MEPs are generally restricted to employers that are members of a trade or industry association or similar group to which there is a greater degree of exclusivity.

The advantages of MEPs are numerous: As the plan sponsor, the MEP provider files one Form 5500 annually for all adopting employers in the plan; and if an audit of the plan’s financial statements is required, it is performed on a plan-wide basis rather than on an employer-by-employer basis. Administrative and fiduciary functions that would otherwise have to be performed by the employers or their own designated service providers can be outsourced to the Open MEP and its designees. They provide employers with significant flexibility in terms of the benefit structure

SEPTEMBER 2011

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(including determining the amounts of any matching or other employer contributions, vesting, eligibility, etc.) that will apply to their employees, while avoiding the costs of maintaining and updating their own individual plan documents and summary plan descriptions. In sum, the use of a MEP benefits employers by allowing them to minimize their administrative burdens and potential fiduciary liability exposure, and benefits their employees by providing them with access to quality, professional plan services at a manageable cost.

The availability of Open MEPs allows small and mid-sized employers that are not members of a trade or industry association, which may sponsor its own MEP, to take advantage of all these benefits, both on their own behalf and that of their workers. Even the most diligent employers are often ill-equipped to deal with the regulatory complexities of qualified retirement plans, because they lack the internal resources to execute their fiduciary responsibilities. Others simply may give them a low priority or not understand these responsibilities. In the current regulatory and litigation environment, access to professional investment advisory, recordkeeping and other important plan services is critical and should not be regarded as luxuries that are available to employees of only the largest companies.

The purpose of this White Paper is to explore the legal bases for establishing, and operational requirements that apply to, MEPs (and in particular, Open 401(k) MEPs) under the Code and ERISA, including analysis of the policy considerations for supporting Open 401(k) MEPs as a viable alternative for employers to provide their employees with tax-advantaged retirement benefits. In preparing this White Paper, we have worked with 401k SAFE, which is an Open MEP plan sponsor that serves employers across the country to help them mitigate their liability and compliance burdens of sponsoring a 401(k) plan. By transferring their role as plan sponsor to 401k SAFE, these employers eliminate the need to file a Form 5500 or conduct a plan audit, to administer plan provisions and compliance requirements, including amending the plan document to comply with changes in the law, or to fulfill most fiduciary obligations to which they would otherwise be subject, such as selecting and monitoring investments and evaluating expenses.

Executive Summary

A MEP is a single retirement plan covering a number of unaffiliated employers, with centralized administrative and fiduciary structures.

There is a clear legal basis for establishing MEPs under the Code, and in fact, the Code and Treasury Regulations provide special rules for MEPs. For example, in order to satisfy the Code requirement that a qualified plan trust must be maintained for the exclusive benefit of an employer's own employees and their beneficiaries, the Code provides that all MEP participants are treated as the employees of all the participating employers.

In addition, there are special operational rules that apply to MEPs under the Code. For example, some of the Code requirements that generally apply to qualified retirement plans must be applied on a plan-wide basis by MEPs, such that the failure by one employer to maintain the plan in satisfaction of the qualification requirements of the Code will result in disqualification of the plan for all employers maintaining the plan.⁵ (In light of the IRS correction program for qualified plans, described later, it is unlikely that actions or inactions by one participating employer would cause a MEP to actually be disqualified. Further, it may be possible to draft plan provisions that

would significantly ameliorate, if not entirely eliminate, this risk.) Still other requirements are applied on an employer-by-employer basis, such as coverage and nondiscrimination testing of benefits, so that, for each employer, the MEP is subject to the same rules for discrimination against rank-and-file employees as those that apply to individual plans.

Under ERISA, there is likewise a legal basis for establishing and maintaining MEPs generally, as well as Open 401(k) MEPs in particular. And given the advantages that Open 401(k) MEPs can provide – especially to small and mid-sized plan sponsors – it would seem that from a policy perspective there is no reason why the use of Open MEPs should be prohibited or restricted.

Analysis and Discussion

Open 401(k) MEPs are offered by independent providers for adoption by small and mid-sized employers. The provider is the plan sponsor and is responsible for creating and updating the MEP's governing document, which lays out the general operational provisions of the plan, including those that are required to ensure ongoing compliance with the requirements of the Code and ERISA. The plan document also establishes the identity of the "Plan Administrator"⁶ and the "Named Fiduciary,"⁷ which will generally be the plan sponsor/provider (or, in some cases, the provider's advisory committee). This means that the plan sponsor/provider, rather than the participating employers, will be responsible for: executing most of the administrative and fiduciary functions required by law or otherwise for the plan's operation, such as providing plan participants with certain disclosures; the appointment of other service providers, such as investment advisors and managers; and the selection and monitoring of the plan's investment alternatives.

Employers adopting an Open MEP will ordinarily execute a participation or joinder agreement that provides for the employer's participation and establishes certain specific provisions, such as the types and amounts of employer contributions (if any), that the participants working for that employer will be entitled to receive. Also, employers in an Open MEP are permitted to select the eligibility and vesting provisions that will apply to their own employees. Because there is no requirement that all employers in an Open MEP provide the same benefits, the individual employers retain much of the flexibility they would enjoy if they were sponsoring their own single-employer plans.

The following sections of this White Paper analyze the structure of Open MEPs, including those with 401(k) features, and how they operate under the Code and ERISA.

MEPs Under the Code

MEPs are described in Code section 413(c) and the Treasury Regulations issued thereunder,⁸ which also contain a number of special operational requirements that MEPs must satisfy. In order to constitute a MEP, the Treasury Regulations require that only two conditions be met:

- The plan is a single plan, and
- The plan is maintained by more than one employer.

As to the first condition, the IRS considers a plan to be a "single plan" only if, "on an ongoing basis, all of the plan assets are available to pay benefits to employees who are covered by the plan and their beneficiaries."⁹ If a portion of a plan's assets are not available to pay some of the promised benefits, the IRS will consider the plan to constitute multiple plans.¹⁰ This is the key distinction between a true MEP, which is a single plan, and multiple plans that may share a single plan document and/or funding vehicle. That is, in a MEP, the assets of the plan are not segregated on an employer-by-employer basis. The IRS has also clarified that a plan may be considered a single plan even if it:

- Is funded through allocated insurance instruments;
- Has several distinct benefit structures that apply either to the same or different participants;
- Has multiple plan documents;
- Permits several employers, *whether or not affiliated*, to contribute to the plan;
- Holds assets that are invested in several trusts or annuity contracts; or
- Employs separate accounting for purposes of cost allocation (but not for purposes of providing benefits under the plan).¹¹ [Emphasis added.]

In sum, despite the fact that a MEP is a single plan, the Code permits participating employers to retain a great deal of flexibility to tailor the individual benefit structures of the plan to suit their business needs and the needs of their workforces.

With respect to the second requirement, that a MEP must be maintained by "more than one employer," it is important to understand exactly what is meant by this term. For qualified plan purposes, the Code requires employers that are members of the same controlled group of corporations, are otherwise under common control, or are members of the same affiliated service group (collectively, Affiliates) be treated as a single employer.¹² Accordingly, in order to constitute a MEP, a plan must be maintained by at least two employers that are not Affiliates. If only one employer participates in a plan, or if all participating employers in a plan are Affiliates, the plan will be a single employer plan, not a MEP. While a MEP must be a "single plan," it cannot be a "single employer plan."

It is also instructive to examine what a MEP is “not” in two other contexts:

- First, a MEP is not a *multiemployer* plan, which is a plan maintained pursuant to a collective-bargaining agreement to which employers whose employees are represented by the union must contribute. Although multiemployer plans generally do cover the employees of multiple, unaffiliated employers, multiemployer plans are subject to Code section 413(a) and (b), which establishes a different set of rules than those that apply to MEPs.
- Second, a MEP is not a Multiple Employer Welfare Arrangement, or “MEWA.” A MEWA is a health plan (or other plan providing welfare benefits, as opposed to retirement benefits) that covers employees of multiple, unaffiliated employers. For reasons that will be explored in more detail later, MEWAs have fallen into regulatory disfavor for reasons that do not apply in the MEP context. Accordingly, it is important to recognize the difference between the two.

Individual Account MEPs

The requirement that a MEP must be a “single plan” under which all of the plan assets are available to pay all plan benefits raises the question of whether an individual account plan, such as a 401(k) plan, can be a MEP. Like many requirements that were established years ago, the IRS’ definition of a “single plan,” which was written in

1979, primarily contemplates defined benefit pension plans under which all plan assets are pooled, as opposed to being maintained in individual participant accounts.

Nonetheless, it is clear that individual account MEPs, including 401(k) MEPs, are permissible under the Code. First, there is no provision in Code section 413(c) and the Treasury Regulations thereunder (or otherwise in the Code) that restricts the types of plans that can be MEPs, other than the requirement that the plans and their trusts must satisfy the qualification requirements under Code section 401(a). Under section 401(a), qualified plans include pension, profit sharing and stock bonus plans. Treasury Regulations establish unequivocally that “a trust forming part of a plan of several employers for their employees will be qualified if all the (qualification) requirements are otherwise satisfied.”¹³ It bears noting that a 401(k) plan is not a distinct type of plan under the Code, but, rather, is simply a profit sharing or stock bonus plan that has an elective deferral feature.¹⁴ Therefore, 401(k) MEPs are likewise permissible.

In addition, more recent guidance from the IRS has affirmed its position that MEPs can be individual account plans. Specifically, in Revenue Procedure 2002-21, the IRS held that 401(k) plans could be maintained by PEOs for the benefit of employees of multiple, unaffiliated employer-clients, notwithstanding any concerns about the “all assets/all benefits” rule described above.

Analysis

Revenue Procedure 2002-21

To understand the application and importance of Revenue Procedure 2002-21 in the context of individual account MEPs, some historical context is useful.

Prior to 2002, the IRS was engaged in an ongoing dispute with the PEO industry: Many PEOs had established 401(k) and other qualified retirement plans that they treated as “single employer plans.” PEOs are organizations that allow their employer-clients to outsource their human resources functions by having the PEO “hire,” and thus become the employer-of-record of, their workers. (These workers are commonly referred to as “Worksite Employees.”) Thus, it was the position of the PEO industry that the Worksite Employees were, in fact, employees of the PEOs, and the PEOs were therefore entitled to establish single-employer retirement plans to cover them.

The IRS did not share this viewpoint. Rather, it was the position of the IRS that in situations where the employer-clients retained the power to direct and control the activities of the Worksite Employees, which is often the case in the PEO context, the Worksite Employees were not employees of the PEO. Accordingly, any plan sponsored by the PEO for their benefit therefore failed to satisfy the qualification requirement that a plan trust must be maintained for the “exclusive benefit” of an employer’s own employees and their beneficiaries.¹⁵ The IRS found support for its position in a number of court rulings, including that of the Supreme Court in *Nationwide Mutual Insurance Co. v. Darden*, in which the Court found that the “right to control the manner and means by which the product (of a worker’s services) is accomplished” is the key to defining the employee/employer relationship in a benefit plan context.¹⁶

In order to avoid the consequences of mass disqualification of hundreds of PEO retirement plans, the IRS issued Revenue Procedure 2002-21, in which it gave PEOs the option of terminating their purported single employer plans or converting them into MEPs, for which it laid out detailed transitional and operational rules. In doing so, it also endorsed individual account MEPs as a viable option for providing defined contribution plan benefits to the employees of multiple, unaffiliated employers.

Specific MEP Rules: Code section 413(c)

Code section 413(c) and the Treasury Regulations issued thereunder are fairly brief provisions, but they accomplish a great deal in terms of enabling MEPs to satisfy certain qualification requirements that would otherwise be problematic, and guaranteeing that the normal Code protections for qualified plan participants are fully afforded to MEP participants.

Specifically, the provisions governing MEPs require that some of the Code’s qualification requirements be applied

separately to the employees of each employer (as if each employer was maintaining its own separate plan), while others are applied on a plan-wide basis.

Requirements that are applied on an employer-by-employer basis include:

- **Coverage Testing.** Code section 410(b) requires generally that a qualified plan must benefit a minimum number of the employer’s non-highly compensated employees (NHCEs), determined in relation to the number of highly-compensated employees¹⁷ (HCEs) that benefit from the plan. Under a MEP, these

tests must be performed on an employer-by-employer basis.¹⁸ This ensures that rank-and-file employees will be covered by a MEP to the same extent they would be if the employer sponsored its own plan.

- **Nondiscrimination Testing.** Under the Code, the amounts of contributions made by, or allocated to the plan accounts of, HCEs likewise cannot exceed the amounts of NHCE contributions by more than certain thresholds.¹⁹ In a MEP, these tests are applied separately on the basis of each participating employer.²⁰ While a full analysis of the tests for various contributions that may be allocated under a 401(k) plan is beyond the scope of this White Paper, they include (i) the Actual Deferral Percentage (ADP) test that applies to pre-tax and Roth 401(k) deferrals,²¹ (ii) the Actual Contribution Percentage (ACP) test that applies to employer matching and employee after-tax contributions,²² and (iii) the general nondiscrimination test that applies to profit-sharing and similar “non-elective” employer contributions.²³ Again, the requirement that these tests be performed separately for each participating employer ensures that rank-and-file employees enjoy the same nondiscrimination protections they would under a single employer plan.
- **Deductibility of Contributions.** The Code limits the dollar amount of plan contributions that can be deducted for an employer’s Federal tax purposes in a given year, and, under a MEP, these limits are applied separately on the basis of each participating employer, except in the case of a MEP established on or before December 31, 1988 that did not elect for this treatment to apply.²⁴

Requirements that are applied on a plan-wide basis include:

- **Eligibility Service.** Code section 410(a) generally requires that an employee cannot be required to perform more than one year of service for an employer as a condition to participate in a qualified plan of the employer.²⁵ Under a MEP, service for all participating employers must be aggregated for this purpose, as if all the participating employers were a single employer.²⁶ In an Open MEP, where there is no relationship between the participating

employers other than shared participation in the plan (as opposed to a MEP sponsored by an association of employers in the same industry), this requirement will rarely be applied.

- **Vesting Service.** Code section 411 establishes minimum vesting standards under which benefits derived from employer contributions must become nonforfeitable on the basis of service provided to the employer.²⁷ Again, under a MEP, service for all participating employers must be aggregated for this purpose,²⁸ but this requirement will not likely need to be applied very often in an Open MEP context.
- **Plan Qualification, Generally.** Under a MEP, plan qualification is determined on a plan-wide basis, meaning that a qualification failure with respect to one employer maintaining the plan could result in the disqualification of the entire plan.²⁹ However, the IRS has established a comprehensive program, the Employee Plans Compliance Resolution System (EPCRS), which permits qualified plans to correct qualification failures voluntarily before the IRS discovers them (under its Self-Correction Program and Voluntary Correction Program, as applicable to particular situations), or even after they are discovered pursuant to an IRS audit (under its Audit Closing Agreement Program) and avoid actual plan disqualification.³⁰ MEPs, like all other qualified plans, are entitled to use EPCRS, and this risk can therefore be greatly mitigated.
- **Treatment of Employees for Purposes of the “Exclusive Benefit” Rule.** Under Code section 401(a)(2), a trust that is part of a plan will only be a qualified trust if it is maintained for the exclusive benefit of the employer’s own employees and their beneficiaries. In the MEP context, each employer clearly participates in a plan and trust that benefits persons other than its own employees and their beneficiaries. To satisfy this requirement (that would otherwise preclude a MEP from achieving qualified plan status), Code section 413(c)(2) provides that all plan participants are considered to be the employees of each participating employer. It is important to note that this treatment applies only for this very narrow purpose, and does not otherwise create any type of employment relationship or obligation between any participating employer and the employees of another employer.

Analysis

Exclusive Benefit Rule

Some commentators have raised the question of whether the exclusive benefit rule means that the organization offering the MEP must make it available to its own in-house employees (in addition to the employees of its employer-clients). Certainly, the plan sponsor/provider could choose to resolve any ambiguity in this respect by offering the MEP to its own employees, but concerns over this issue may be the result of an overly-rigid reading of this requirement.

First, Code section 413(c) refers to MEPs as “(p)lans maintained by more than one employer,” and there is no indication in the Code or Treasury Regulations that any one employer participating in a MEP must be treated as the “primary” employer maintaining the plan and its trust. The IRS does make reference in Quality Assurance Bulletin FY2004 – No. 2 (Issued June 4, 2004) to the concept of a “lead employer,” but this Bulletin only reflects the requirement that a lead employer must be named in the paperwork submitted as part of a plan’s determination letter filing. Given these facts, it would be reasonable to conclude that the IRS views all the participating employers in a MEP as being the parties maintaining the plan and its trust. Thus, it is questionable whether the plan sponsor/provider is likewise considered to be “maintaining” the plan and trust, such that its own employees would have to be covered.

Second, it should be noted that Revenue Procedure 2002-21, which endorsed the use of MEPs in the PEO context, does not specifically require that a PEO’s own employees would have to be covered by its MEP in order to satisfy the exclusive benefit rule. While the Revenue Procedure does cite the rule generally, it makes no specific reference to the PEO’s own employees, so it would appear that it was not the IRS’ intention was to require that in-house PEO employees be covered in order for a MEP to satisfy this qualification requirement.

Open MEPs Under the Code

As noted above, the term “Open MEP” refers to a MEP that is offered by an independent provider for adoption by any employer, as distinguished from a MEP sponsored by an industry or trade association whose membership is restricted. There is no requirement in the Code or any Treasury Regulation that employers participating in a MEP must be members of the same industry or otherwise have any kind of pre-existing relationship (Commonality) with one another. Once again, the only Code requirement pertaining to which employers may participate in a MEP is that they must be unaffiliated. Accordingly, the Code does not seem to recognize any difference between an Open MEP and any other MEP, and both are equally permissible.

This conclusion is also bolstered by Revenue Procedure 2002-21, pertaining to PEO MEPs. The employer-clients of a PEO ordinarily are not all members of the same industry and do not share any other common bond, other than their relationship with the PEO, and the IRS’s apparent endorsement of these arrangements suggests that, for tax purposes, it does not contemplate any Commonality requirement that would preclude the establishment of an Open MEP.

MEPs Under ERISA

As is the case under the Code, there is a clear legal basis under ERISA for establishing and maintaining a MEP. Specifically, ERISA requires that a plan must be established either by (i) an employer or (ii) an employee

organization³¹ (i.e., a union). Thus, in the MEP context, it is important to determine what entity is the “employer.” ERISA section 3(5) states that

(t)he 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.* [Emphasis added]

Accordingly, the plain language of ERISA permits a plan to be established and maintained by (i) a single employer, (ii) a person acting indirectly in the interest of an employer (the term “person,” as defined in ERISA includes individuals, corporations, partnerships and most other legally-recognized entities³²), (iii) a group of employers or (iv) an association of employers. Therefore, there is no question that MEPs are generally permissible under ERISA.

Open MEPs Under ERISA

For an Open MEP, the employer that establishes and maintains the plan is not a single employer, and is likely not an “association” of employers in the viewpoint of the DOL. However, it is reasonable to conclude that the employer under an Open MEP may be either the (i) plan sponsor/provider (based on the fact that it is acting indirectly in the interests of the participating employers with regard to an employee benefit plan), or (ii) a group of participating employers (acting in the same capacity). The latter interpretation is more consistent with the Code’s treatment of MEPs as “plans maintained by more than one employer.” Of course, an Open MEP’s plan document and most aspects of its operational structure are established and maintained by the provider, but this is no different than other benefit outsourcing arrangements such as prototype and volume submitter plans, under which fiduciary functions such as investment management and trust or custodial services are performed by third parties.

Employer Commonality. Some DOL officials recently made comments to a group of retirement plan practitioners indicating that a MEP would not satisfy the ERISA requirement of being established and maintained by an employer unless there is significant Commonality between the participating employers (such that there would be a bona fide “group” or “association” of employers). If this were the case, it is likely that an Open

MEP would be considered by the DOL to constitute several separate plans rather than one, and that some of the benefits of the single plan would be unavailable.

There are several ERISA Advisory Opinions (and court rulings, which rely heavily on these Opinions) that appear to support this position at first blush. However, a closer examination indicates that reliance on them may be largely misplaced with respect to MEPs, for the reasons set forth below. It is also important to recognize that the informal comments noted above do not represent any official DOL interpretive or enforcement policy. Given the current state of the matter, it does not appear that there is a reason for employers that are considering participation in an Open MEP to refrain from doing so or for employers that are currently participating in an Open MEP to withdraw from it.

Confusion Between MEWAs and MEPs. A significant majority of the ERISA Advisory Opinions and court rulings noted above that purportedly support the position that employers under a MEP must satisfy some Commonality requirement, were in fact applying this requirement to MEWAs rather than MEPs.³³ The distinction between MEWAs and MEPs is important for two reasons:

- First, even in an Open MEP, there is some unavoidable degree of Commonality between the participating employers that is not present under a MEWA. As noted earlier, employee eligibility and vesting service is aggregated across all participating employers in a MEP, and all participants are treated as employees of all the participating employers for purposes of satisfying the Code’s exclusive benefit rule. Thus, to the extent that there is a Commonality requirement for MEPs, these factors ensure that employers in a MEP will have more of a common employment-related bond than participating employers in a MEWA, for which there are no analogous “employee aggregation” rules. In light of the lack of MEP-specific guidance with respect to the purported Commonality requirement, the Code’s employee aggregation rules may well achieve all the Commonality necessary.
- Second, as a general statement, MEWAs have an abusive history³⁴ that has resulted in the DOL discouraging their use for policy reasons that do not apply to MEPs. Specifically, in the past, certain unscrupulous providers offered MEWAs to multiple, unrelated employers as

a means of providing inexpensive health and other welfare benefits to their employees. Those providers attempted to evade state insurance regulations mandating minimum reserve levels and the like by arguing that the MEWAs were ERISA-covered welfare plans that were exempt from state regulation under ERISA's preemption clause.³⁵ As a result, some of these providers collected premiums from the employers, but, faced with benefit obligations that they could not meet (or, in fact, may never have intended to meet), declared bankruptcy and left the MEWA participants with no health coverage. ERISA was amended in 1983 to provide that MEWAs are subject to state insurance regulation in an effort to prevent this abusive practice from re-occurring,³⁶ but it is likely that the DOL's resulting distrust of MEWAs was a significant factor in its efforts to prevent their formation by applying a Commonality requirement to participating employers.

The policy considerations surrounding past MEWA abuses simply do not apply in the context of an Open MEP. Participants in an Open MEP are afforded all of the Code and ERISA protections that participants in single employer and multiemployer plans enjoy, and accordingly, there is no apparent policy reason for treating them differently or otherwise discouraging their use.

Lack of DOL Guidance in the Retirement Plan Context.

The few ERISA Advisory Opinions that discuss the issue of retirement arrangements maintained by multiple employers do not squarely address Open MEPs. The distinction between this type of arrangement and others that provide retirement benefits to multiple employers is important because, in an Open MEP, the primary purpose of the plan sponsor/provider and that of the participating employers (taken as a whole and as a group) is the provision of retirement benefits. Accordingly, referring back to ERISA's definition of an "employer" that can sponsor a retirement plan, the independent provider can be more reasonably construed as a person "acting indirectly" in the interest of an employer in relation to an employee benefit plan, and a group of participating employers can be more reasonably construed as a group of employers acting in such capacity, than other entities that the DOL has found not to constitute "employers" for this purpose. By way of contrast, in two often-cited ERISA Advisory Opinions, the DOL found that certain organizations that were not organized primarily for the purpose of providing retirement benefits, and were open to membership by individuals and other non-employers, were not bona fide groups of employers, and therefore, were not employers under ERISA.³⁷ In other words, the

DOL found that, because of their membership structures, those organizations did not constitute a "group or association of employers." As a result, these holdings are of limited relevance, as they rely heavily on factors that are not applicable to Open MEPs, in which the "members" are and may only be employers.

No Official DOL Enforcement Position. Currently, there is no DOL policy or enforcement agenda targeted at Open MEPs, and there has been no official announcement indicating that the DOL intends any particular regulatory activity in the future. Accordingly, notwithstanding the informal comments made by DOL representatives mentioned above, there is no current reason to anticipate that the DOL will take any active role in restricting Open MEP participation.

In addition, from a policy perspective, there does not appear to be a compelling reason for it to do so. From an ERISA fiduciary standpoint, a MEP (including an Open MEP) can be viewed as virtually the antithesis of an abusive MEWA, in the sense that MEPs tend to enhance fiduciary compliance and the availability (to small and mid-sized employers) of professional investment advisory and other important ancillary services while still providing full protection for accrued benefits under Code and ERISA mandates. Further, given the fact that Open MEPs are clearly permissible under the Code, regardless of the Commonality of participating employers, it might also be difficult – though certainly not impossible – for the DOL to take a contrary position. At the very least, we would anticipate that there would be serious dialogue between the agencies before a change in position by the DOL would be formalized.

Consequences of Adoption of Formal Position. Even if the DOL were to adopt a formal position holding that Open MEPs are not permissible, the consequences would be relatively minor. That is, the plan would be treated as a collection of individual single employer plans. From a tax perspective, the plans would retain their qualified status, the plan document would remain compliant, the tax benefits of a qualified plan would be retained, and the employers would not lose their deductions for contributions to the plan.³⁸ From an ERISA perspective, there would be additional consequences, but, in our view, they would also be minimal. It would continue to be permissible for each plan to appoint the same Plan Administrator, Trustee and Named Fiduciary. It would continue to be permissible for the assets of each plan to be invested in a commingled trust. What would change would be the following:

- Each separate plan would probably need to obtain a fidelity bond in the amount required by ERISA, since it is likely that the bond obtained

by the MEP would not be adequate. These bonds are inexpensive – perhaps as little as a few hundred dollars;

- Each separate plan would need to file a Form 5500; and
- To the extent any separate plan has 100 or more participants, it would need to obtain an annual accountant's audit of the plan's financial position, as opposed to being able to rely on the audit of the combined plan (For employers with fewer than 100 participating employees, no annual audit would be required).

In addition, the impact of these last two requirements might well be ameliorated by the fact that they might be able to rely on a filing by the commingled trust.³⁹ Further, even if the DOL were to take an official enforcement position that Open MEPs are impermissible due to a lack of employer Commonality or another factor, we believe the DOL might apply the position only prospectively to new plans, or provide transitional relief to existing plans and participating employers.

Plan Sponsor Compensation. In the current Open MEP market, there are various MEP plan structures, including

plans operated by third party administrators (TPAs), plans operated by Registered Investment Advisors (RIAs), and plans operated by independent plan sponsors. Regardless of the questions raised as to ERISA's treatment of these various plan structures, the rules under ERISA related to the compensation of the provider of the MEP are clear: the plan sponsor/provider, as a fiduciary to the plan, cannot determine its own compensation and cannot pay itself out of plan assets. As one commentator has noted:

"One rule that is clear under ERISA is that a fiduciary cannot exercise its power as a fiduciary to pay itself a profit from the plan assets. Repeatedly, the Department of Labor has required that (1) if a fiduciary is rendering services to a plan and (2) receiving payment and (3) those payments include a profit component, the amount of those payments must be approved by another fiduciary of the plan. These rules apply to any plan fiduciary, including banks, registered investment advisers or anyone else."⁴⁰

Conclusion

Open 401(k) MEPs are one of the few options available for most employers that wish to comprehensively mitigate their fiduciary responsibilities and exposure to liability, and outsource their administrative compliance burden, while providing their employees with the maximum tax-deferral opportunity afforded under the Code, as well as possible tax-deferred employer contributions for retirement. Participation in an Open 401(k) MEP can help avoid the administrative burden of overseeing compliance requirements by allowing an independent plan sponsor to oversee the servicing requirements for their participants and beneficiaries.

These arrangements are clearly permissible under the Code, which provides detailed operational rules to help ensure that the plans continue to satisfy all qualification requirements, and that participants are afforded all the same protections that participants in single employer and multiple employer plans enjoy.

There is support for the establishment of Open 401(k) MEPs under ERISA as well. Informal comments by some DOL officials have created a degree of alarm

across the retirement plan industry that, while certainly understandable, appears to be excessive under the circumstances. A fair, common sense reading of ERISA's requirements, taking into account relevant policy considerations, suggests that there is no likely reason to fear that Open MEPs are in imminent danger from regulators. There is no activity that suggests the DOL intends to take a formal policy or enforcement position that would preclude Open MEPs due to a lack of employer Commonality, and current regulatory trends over plan fees and similar issues would indicate that the DOL should work to resolve any ambiguities in the law and therefore encourage Open MEP participation rather than discouraging it.

Although Open MEPs are being discussed as something new, they are clearly a continuation of the established MEP plan structure. The advantages they offer should be a consideration for any employer exploring their fiduciary and administrative options.

Endnotes

- ¹ See ERISA §404(a).
- ² ERISA §404(a)(1)(B).
- ³ See, e.g., *Donovan v. Bierwirth*, 680 F.2d 263, 272 (2d Cir. 1982); and *Howard v. Shay*, 100 F.3d 1484, 1488 (9th Cir. 1996).
- ⁴ 29 CFR §§2550.408b-2 and 2550.404a-5.
- ⁵ Treas. Reg. §1.413-2(a)(3)(iv).
- ⁶ The terms “plan administrator” and “administrator” are defined in IRC §414(g) and ERISA §3(16)(A), respectively, as “the person specifically so designated by the terms of the instrument under which the plan is operated” unless no such designation is made. It is important that a MEP’s governing document define these terms, to prevent the adopting employers from being treated as the Plan Administrators under default rules that apply when no such designation is made.
- ⁷ A plan’s “named fiduciary,” as such term is defined in ERISA §402(a)(2), is likewise named in the plan’s governing document.
- ⁸ Specifically, IRC §413(c) and Treas. Reg. §1.413-2 refer to MEPs as “(p)lans maintained by more than one employer.”
- ⁹ See Treas. Reg. §1.413-2(a)(2), incorporating the definition of a “single plan” under Treas. Reg. §1.414(l)-1(b)(1).
- ¹⁰ Treas. Reg. §1.414(l)-1(b)(1).
- ¹¹ *Id.*
- ¹² See IRC §414(b), (c), and (m), and the Treasury Regulations promulgated thereunder.
- ¹³ Treas. Reg. §1.401-1(d).
- ¹⁴ See Treas. Reg. §1.401(k)-1(a)(1). In addition to profit sharing and stock bonus plans, pre-ERISA money purchase and rural cooperative plans may also include 401(k) features. *Id.*
- ¹⁵ See IRC §401(a)(2).
- ¹⁶ See generally 503 U.S. 318 (1992).
- ¹⁷ See IRC §414(q). Generally, a highly compensated employee is one that either, during the previous year, (i) earned more than \$110,000 in compensation from the employer (this dollar threshold is subject to periodic adjustments by the IRS), or (ii) owned 5% or more of the employer.
- ¹⁸ Treas. Reg. §1.413-2(a)(3)(ii).
- ¹⁹ See IRC §401(a)(4) and Treas. Reg. §1.401(a)(4)-1&2.
- ²⁰ Treas. Reg. §1.413-2(a)(3)(iii).
- ²¹ See generally IRC §401(k)(3) and Treas. Reg. §1.401(k)-2.
- ²² See generally IRC §401(m) and Treas. Reg. §1.401(m)-2.
- ²³ See generally IRC §401(a)(4) and Treas. Reg. §1.401(a)(4)-1&2.
- ²⁴ IRC §413(c)(6). The deductibility of employer plan contributions is governed by IRC §404 and the Treasury Regulations issued thereunder.
- ²⁵ See IRC §410(a) and Treas. Regs. §§1.410(a)-1-5, which contain the Code’s maximum eligibility service requirements. Plans under which a participant’s employer-derived benefit is fully vested upon accrual may condition plan eligibility on the performance of no more than two years of service. IRC §410(a)(1)(B)(i).
- ²⁶ IRC §413(c)(1) and Treas. Reg. §1.413-2(b).
- ²⁷ IRC §411(a)(2)(B).
- ²⁸ IRC §413(c)(3) and Treas. Reg. §1.413-2(d).
- ²⁹ Treas. Reg. §1.413-2(a)(3)(iv).
- ³⁰ The EPCRS program is described in Rev. Proc. 2008-50.
- ³¹ The definition of the term “employee benefit pension plan,” or “pension plan” is codified in ERISA §3(2)(A).
- ³² See ERISA §3(9).
- ³³ See, e.g., ERISA Adv. Op. 79-41A (June 29, 1979); ERISA Adv. Op. 89-17A (August 17, 1989); ERISA Adv. Op. 94-07A (March 13, 1994); *Atlantic Health Care Benefits Trust v. Foster*, 809 F. Supp 365 (D.C. Pa. 1992); and *MD Physicians & Association Inc v. State Board of Insurance*, 957 F.2d 178 (5th Cir. 1992).
- ³⁴ See DOL publication “Multiple Employer Welfare Arrangements under the Employee Retirement Income Security Act (ERISA): A Guide to Federal and State Regulation,” at <http://www.dol.gov/ebsa/Publications/mewas.html>.
- ³⁵ See ERISA §514.
- ³⁶ See ERISA §514(b)(6).
- ³⁷ See ERISA Adv. Op. 83-15A (March 22, 1983); and ERISA Adv. Op. 88-07A (March 28, 1988).
- ³⁸ This assumes that the plan was qualified prior to being treated as a separate plan.
- ³⁹ See Instructions to Form 5500 related to Direct Filing Entities.
- ⁴⁰ See Stevens & Lee, Client Alert “Multiple Employer Retirement Plans: Payments to Plan Sponsors from Plan Assets” (December 23, 2010).

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