CAPCO

RESURGENCE OF POOLED EMPLOYER PLANS:
A NEW MARKET FOR THE RETIREMENT PLAN INDUSTRY

INTRODUCTION

The United States is in the midst of a retirement crisis in which insufficient retirement savings are being exacerbated by increasing life expectancy.[1] The government has taken efforts to encourage retirement savings by providing tax advantages to businesses and individuals for participating in a plan. However, small businesses with fewer than 100 employees are still less likely than larger businesses to offer any type of retirement plan to their employees due to cost or administrative complexity.[2]

Multiple employer plans (MEPs) were established decades ago to address these concerns by allowing small businesses to share a single plan.[3] However, regulatory ambiguity and roadblocks prevented these plans from gaining traction.[4] This changed in 2019 when the SECURE act was passed, allowing pooled plan providers to begin operating Pooled Employer Plans beginning Jan. 1, 2021.[5]

Pooled employer plans (PEPs) make it possible for multiple small businesses to pool their employee's retirement funds with other small businesses and hire a professional pooled plan provider to handle the administrative responsibilities. PEPs will become an important tool for small businesses looking to provide retirement services to their employees. Retirement plan providers initially dismissive of this market due to the regulatory hurdles and thin margins have started to re-examine the opportunity to serve what amounts to just under half of all U.S. workers, driving product innovation in the process.

THE HISTORY OF POOLED EMPLOYER PLANS

The history of PEPs is rooted in the history of multiple employer plans, a plan "maintained by two or more employers who are not related."[6] The MEP has one plan sponsor and is established by one employer, with other employers joining the plan as adopting employers. The DOL requires participating employers in MEPs to share some common link.

Traditionally, this was interpreted as companies within a common industry. However, in the 2000s, retirement service providers interpreted these requirements more aggressively, such that the commonality between employers was their interest in providing retirement benefits to employees.[4] This interpretation paved the way for the establishment of open MEPs, which effectively allows multiple unrelated companies to set up a common retirement plan.[7] This was the original version of the pooled employer plans we see today.

Open MEPs gained popularity quickly, and one open MEP provider, 401(k) Advantage LLC, decided the rapid growth warranted the submission of a request that the DOL comment on the legality of the new construct.[4] On May 25, 2012, the DOL issued an opinion that the 401(k) Advantage LLC open MEP was not considered a single plan for ERISA purposes.[8] With this opinion, the majority of open MEPs converted to a master trust structure that required each employer to file their own tax and plan documents, making these plans significantly less popular.[4]

On Sept. 21, 2016, the Retirement Enhancement and Savings Act approved by the Senate Finance Committee allowed for the creation of pooled employer plans.[9] The proposed legislation addressed many of the challenges that made open MEPs less popular. The PEP structure transferred legal responsibilities and administrative requirements to a third-party "pooled plan provider" who only needed to maintain a single plan document, audit, and form 5500.[9] The creation of pooled employer plans was cemented through the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act), which published the registration requirements for pooled plan providers and allowed the operation of pooled employer plans to begin on Jan. 1, 2021.[5]

BENEFITS AND LIMITATIONS OF POOLED EMPLOYER PLANS

Now that we understand the history of pooled employer plans, we can explore how they work and what benefits they can provide to small businesses. A PEP is a type of retirement plan that meets specific DOL requirements and provides benefits to two or more unrelated employers. This allows unrelated employers to "pool resources to help achieve economies of scale and administrative efficiencies."[10] A PEP must designate a pooled plan provider (PPP) who is either one of the participating employers or an unrelated financial institution. This PPP takes on the fiduciary responsibility for the plan and typically acts as the plan administrator.[11] A comprehensive list of requirements can be found on the Department of Labor website.[12]

PEPs offer several key benefits that are particularly important for small businesses. A Pew Trust study of employers that do and do not offer retirement benefits showed the biggest barriers were "potential costs, administrative capacity, and familiarity with the options."[13] PEPs directly address all these concerns. They solve the issue of cost by aggregating assets for the purposes of lowering investment and administrative expenses. The PEP structure also shifts administrative and fiduciary responsibility to a PPP that is responsible for adhering to the ERISA and DOL requirements. This includes annual Form 5500 filings, annual plan audits, annual testing, participant loans, distributions, rollovers, plan document, and participant notices.

Finally, PEPs also address the familiarity with options by creating a one-stop shop through pooled plan providers who act as both fiduciary and plan administrator. Employers no longer need to be experts in order to provide retirement plans to their employees. As PEPs are relatively new in the marketplace, it is important that PPPs continue to educate their potential clients and provide transparency around plan options. Technology can play an important role in providing a clear layout of the plan options and a platform for participating employers to monitor their plans.

While there are many benefits of participating in a PEP, there are also some limitations and challenges that employers should consider. First, a PEP may have less flexibility with regard to investment options or plan design. Since PPPs are responsible for the investment options and administration of the PEP, an employer's flexibility comes in the form of choosing a good PEP rather than choosing specific plan features. As a result, employers may not be able to customize the specific investment options offered to their employees nor alter the plan design to suit their specific circumstances. It is also important to note that employers will still retain some administrative responsibility for providing participant data, determining plan contributions, and withholding funds accurately.[14] Pooled plan providers can mitigate many of these drawbacks by using technology to provide greater customization options and streamline the administrative requirements for employers.

INNOVATING TO CAPTURE THE PEP MARKET

Managing a PEP as a pooled plan provider is logistically complicated due to the varying needs of the many participating employers. As retirement solutions providers began registering to become PPPs in 2021, investors quickly recognized that technology would be at the forefront of this new market. In June 2021, Smart, a global retirement technology leader, concluded a $228 million Series D funding round to expand America's access to pooled employer plans.15 Smart's platform as a service model currently powers one of the UK's largest master trusts (UK's PEP equivalent), Smart Pension Master Trust.[15] The technology-led US expansion of Smart demonstrates the growth opportunity and need for technology in the PEP space. Another company leveraging technology to enter the PEP space is Paychex, a leading provider of management solutions for payroll, benefits, HR, and insurance.[16] Paychex uses technology to simplify plan administration and enrollment, while also making it easier for employers and employees to monitor their accounts.[17] Paychex and Smart demonstrate how technology can be used to capture market share while also simplifying the administrative complexity of managing a PEP.

While Paychex and Smart are good examples of technology leaders in the PEP space, the opportunity to enter the PEP market is not limited to service providers. Asset managers, like Fidelity, have also created PEPs to serve clients with small to medium sized businesses.[18] Fidelity's PEP focuses on affordable pricing, technology to reduce plan management, and simplified plan design.[18] The advantage of entering the PEP space as an asset manager lies in cross-selling opportunities for the firm. Fidelity only needs to administer a single Pooled Employer Plan for thousands of employers, whose employees become prospective clients for Fidelity's non-retirement business. Furthermore, Fidelity's Pooled Employer Plan invests in its proprietary funds, increasing AUM for it's funds business.[19]

It is important to note that Fidelity is not charging multiple layers of fees by using its own funds. Fidelity is a great example of how Pooled Employer Plans can create opportunities for growth across multiple lines of business. Asset management firms and plan providers who wish to enter this new market should lead with technology to simplify the process for participating employers and create intuitive user interfaces for employees.

Beyond the technological advancements taking place in the PEP market, many firms are finding creative ways to differentiate themselves strategically. Morningstar is releasing an ESG pooled employer plan in early 2022 to introduce sustainable investment options for small businesses. The plan will invest in managers that incorporate ESG factors into their investment process.[20] Lincoln Financial has conducted research to determine that employees are interested in monthly retirement income for life and leveraged this insight to create a differentiated PEP that provides a guaranteed lifetime income option to plan participants.[21] This solution helps address the longevity risk associated with the aging U.S. population while taking advantage of the PEP model to access small businesses. These examples of differentiation demonstrate the flexibility of the PEP model to allow firms to think strategically about the needs within the retirement market and tailor solutions accordingly.

CONCLUSION

Multiple employer plans have experienced a complicated history riddled with regulatory ambiguity and sporadic popularity. The SECURE Act was passed as the United States' retirement crisis worsened, leading to the revitalization of multiple employer plans in the form of newly branded pooled employer plans. PEPs allow multiple unrelated employers to share a common plan administered by a pooled plan provider. These pooled plan providers take on much of the fiduciary and administrative risk associated with the plan to lower barriers to entry for small businesses to offer retirement plans to their employees.

While pooled plan providers can be one of the participating employers in a plan, this role is most often assigned to an asset management firm or plan provider. Firms who have moved quickly and led with technology in the PEP market have attracted clients by further simplifying the enrollment process and ongoing plan monitoring. Firms that are considering becoming pooled plan providers should lead with a robust technology offering and plan for potential cross-selling opportunities across lines of business. They should also be flexible in the plans they offer to reflect the diverse needs of different client segments (i.e. impact investing) and distinguish their plans among an array of competitors.

Firms that quickly recognize the structural changes leading to this new market within the retirement plan industry and re-examine its potential will not only create growth opportunities for their businesses but will more importantly be turning the tide in America's retirement crisis by enabling more small businesses to offer retirement plans.

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AUTHORS

Matthew Berkowitz, Managing Principal, U.S. Wealth & Asset Management Strategy Practice Lead
matthew.berkowitz@capco.com

Eden Afriat, Senior Consultant, U.S. Wealth & Asset Management
eden.afriat@capco.com

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