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Pooled Employer Plans—the Next Big Thing?

March 2021

Summary

In 2021, unrelated employers will have the option to participate in a Pooled Employer Plan (PEP) without meeting any commonality requirements. PEPs have received significant media attention and could—in theory—transform the U.S. retirement landscape. However, Cerulli notes several headwinds facing this nascent industry, from conflicting employer priorities to complex administrative requirements and a need for competitive pricing to gain traction.

Key Points

- PEPs were introduced as a means to help close the retirement plan coverage gap in the U.S., but Cerulli anticipates that these plans will be "sold, not bought" among employers without a workplace retirement plan already in place.
- Pricing will be key to adoption and achieving scale in a burgeoning PEP market.
- While PEPs are generally perceived as a solution for small businesses, Cerulli observes modest but consistent levels of interest from 401(k) plan sponsors across asset segments.
- Most retirement providers (*e.g.*, recordkeepers, advisors) are still undecided about whether to participate in PEPs, and few are committed to acting as the Pooled Plan Provider (PPP).

On January 1, 2021, one much-anticipated provision of the Setting Every Community Up for Retirement Enhancement (SECURE) Act took effect: the availability of Pooled Employer Plans (PEPs). PEPs, also referred to as "open" multiple-employer plans (MEPs) in prior Cerulli research, allows unrelated employers to participate in the same retirement plan without fulfilling any common nexus requirement (*e.g.*, based on industry or location).

PEPs are generally welcomed as a strategy to close the retirement plan "coverage gap" by offering a simple, cost-effective option to small businesses—as of 2019, close to 90% of private sector organizations with at least 500 employees offer a workplace retirement plan, compared with half of those with fewer than 50 employees. Some industry stakeholders further speculate that PEPs could cannibalize single-employer plan business and set the stage for a superannuation-like system.

Gauging Interest in PEPs

Cerulli notes that, unlike in Australia and the U.K., contributions to retirement plan accounts are not mandatory for U.S. workers or their employers (outside some less common arrangements in already-established 401(a) plans). Small business owners must contend with conflicting priorities; these employers frequently cite cost and the need to prioritize other benefits as obstacles to establishing a workplace retirement plan. As one respondent in a 2019 Cerulli study explains, "The first order of business is paid time off and health insurance...retirement benefits come down the road."

As individuals stress about caretaking, their own health, or their children's hybrid learning schedules, retirement planning has taken a backseat to conversations about wellness and flexible work policies.

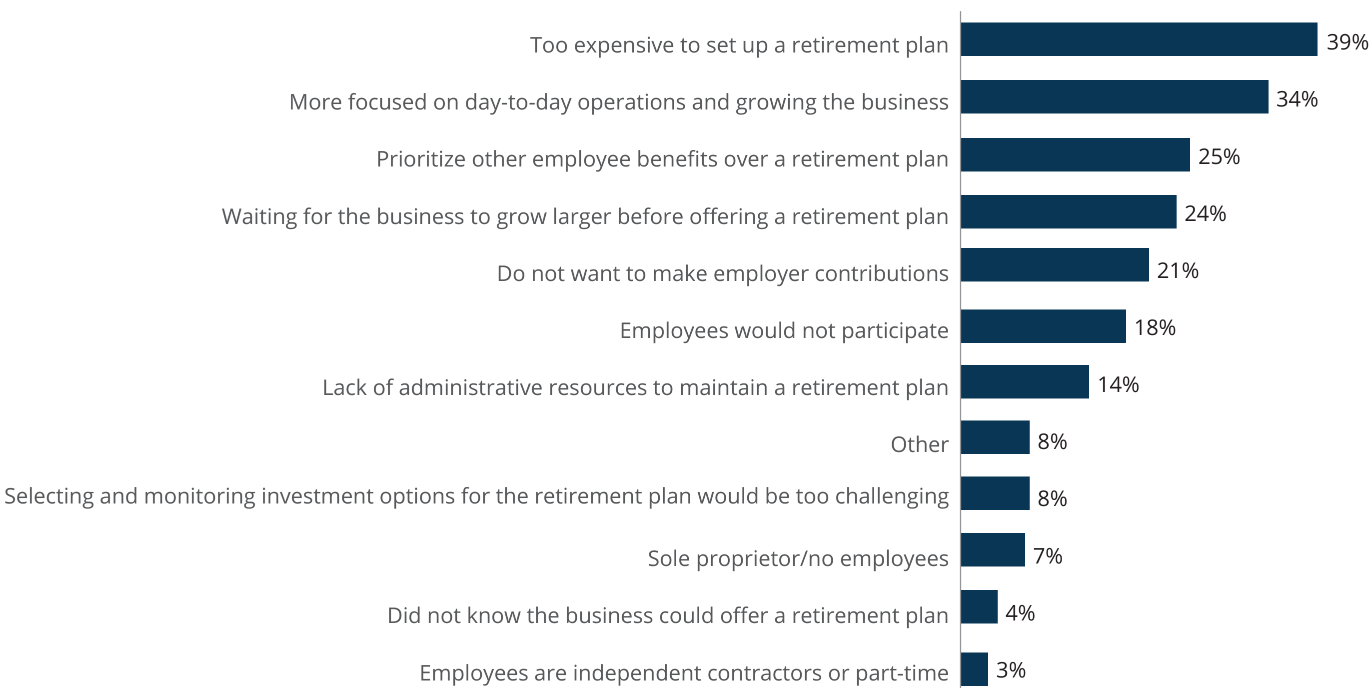
This concern rings truer than ever during a pandemic. With small businesses shuttering left and right, it is a challenging time to expand (and finance) company benefits. As individuals stress about caretaking, their own health, or their children's hybrid learning schedules, retirement planning has taken a backseat to conversations about wellness and flexible work policies.

In this context, Cerulli anticipates that employers without an existing retirement plan will be reticent to join a PEP, and the solution will be "sold, not bought" for this cohort. (It is also worth noting that small business owners seeking to provide retirement coverage have no dearth of current options, from SEP and SIMPLE individual retirement accounts to competitively priced single-employer plans, generally offered by firms looking to bundle recordkeeping services with fund management.)

As for those employers already offering a defined contribution (DC) plan? Based on a Cerulli survey of 401(k) plan sponsors conducted in 4Q 2020, one-quarter are somewhat or very interested in joining a PEP, and this sentiment is fairly consistent across plan asset segments, with the exception of the "mega" market (plans over $1 billion). However, "micro" plan sponsors (with less than $5 million in plan assets) are also the most likely to say they have no opinion on the topic—indicating that further discussion is warranted to educate startups and other small businesses about the full universe of retirement plan options.

Small Businesses Owners' Reasons for Not Offering a Retirement Plan, 2019

Respondents express concern about the expenses associated with a retirement plan. Small employers are often more focused on business operations and providing non-retirement benefits.

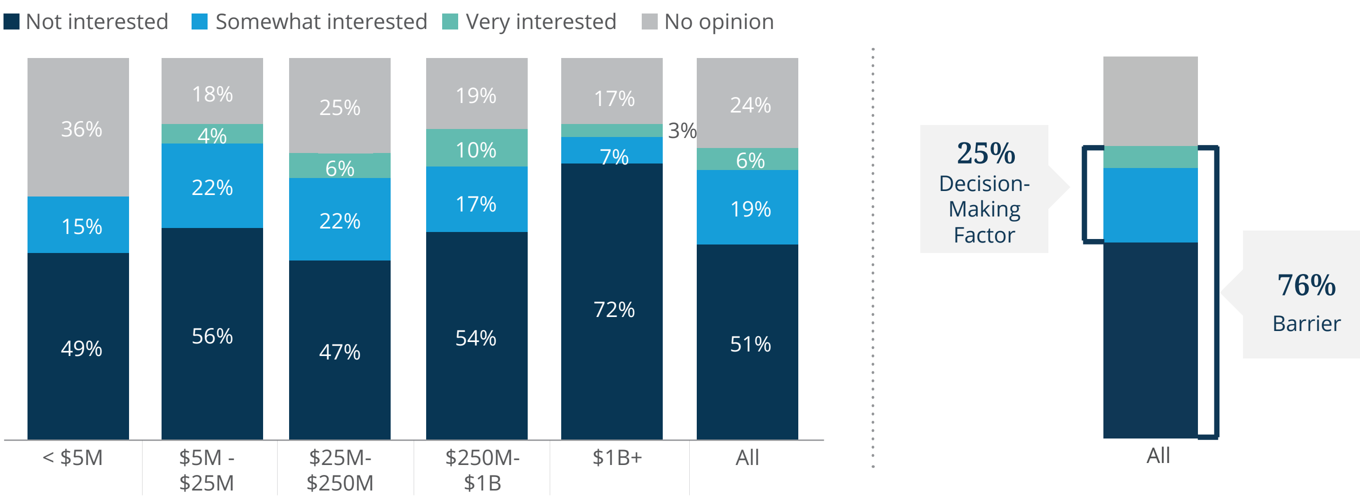


Sources: Cerulli Associates, in partnership with The SPARK Institute | Analyst Note: "Other" includes "turnover is too high," "business owner is already retired," and "not important to offer a retirement plan."

Among those respondents contemplating PEPs, two-thirds indicate that the simplification of plan administration and compliance is a very important factor in their decision-making process when evaluating PEP solutions and providers. One potential benefit of a pooled arrangement is the ability to offload this responsibility away from employers, who may prefer to focus more on day-to-day operations and growing the business. In a June 2020 press release, Aon announced a decision to launch a PEP in partnership with Voya, asserting that with the SECURE Act passing, "Employers will no longer need to sponsor their own individual 401(k) plan and absorb the risks and workload associated with that role." (Notably, the desire to outsource fiduciary liability seems to weigh less heavily in plan sponsors' decision-making.)

401(k) Plan Sponsors' Current Interest in PEPs, 4Q 2020

One-quarter of 401(k) plan sponsors are somewhat or very interested in joining a PEP.



Decision-Making Factor	Unsure/Not Applicable	Not Important	Somewhat Important	Very Important
Simplification of plan administration/compliance	3%	2%	28%	67%
Lowering investment costs	4%	5%	33%	57%
Lowering plan administrative costs	4%	1%	41%	54%
Simplification of investment selection/monitoring	3%	2%	42%	53%
Access to participant education and financial wellness	6%	6%	36%	52%
Outsourcing fiduciary liability	4%	13%	34%	48%

Barrier	Unsure/Not Applicable	Not a Barrier	Somewhat of a Barrier	Significant Barrier
Prefer to stay involved in investment selection	8%	15%	35%	43%
Plan is already competitively priced	11%	15%	32%	43%
Prefer having a custom plan design (*e.g.*, match or vesting provisions)	13%	17%	28%	41%
Moving to a PEP would be perceived negatively by employees	12%	13%	34%	41%
No capacity for a major strategic benefits change (*e.g.*, HR or legal resources)	7%	21%	33%	39%
PEPs are unlikely to reduce fiduciary liability	15%	32%	32%	21%
We have assets in the plan that would be difficult to transfer (*e.g.*, annuities)	18%	32%	28%	22%

Source: Cerulli Associates | Analyst Note: Respondents with an interest in PEPs were asked, "How important are the following attributes in deciding whether to join a PEP and selecting a Pooled Plan Provider (PPP)?" Respondents with any opinion on PEPS were also asked, "What are the barriers or drawbacks to joining a PEP?"

One potential benefit of a pooled arrangement is the ability to offload this responsibility from employers, who may prefer to focus more on day-to-day operations and growing the business.

Individual employers within a PEP are not required to file a Form 5500; furthermore, unlike with traditional MEPs, PEPs will not be disqualified in the event of "one bad apple" failing to meet Internal Revenue Service requirements. However, maintaining a retirement benefit is far from effortless. Employers wanting to offer a PEP remain responsible for the prudent selection—and monitoring of—their pooled plan provider (PPP). Employers may also need to distribute communication materials, furnish participant-related data, or coordinate with payroll systems to facilitate plan administration.

Among those plan sponsors with an opinion on the subject of PEPs, more than three-quarters prefer to stay involved in the investment selection process, and a similar majority feel their 401(k) is already competitively priced. Cerulli believes that pricing will be key to winning new business in this market. When asked to consider their biggest challenges in providing a retirement plan, small business plan sponsors (with fewer than 100 employees) most commonly point to issues of cost—whether total benefits spend (79%), employer contributions such as match (69%), or costs associated with plan administration and compliance (64%).

Evolving to Serve the PEP Market

Following the SECURE Act's proposal, a question emerged as to which organizations might serve this burgeoning market and—most importantly—function as the PPP. In general, small business owners express more confidence and trust in financial institutions (*e.g.*, recordkeepers, financial advisors) than associations or government organizations, whether that relates to establishing a plan and selecting investments, engaging employees, or maintaining compliance (see *The Cerulli Edge—U.S. Retirement Edition: 2Q 2019*).

DC Recordkeepers' Outlook for ARPs and PEPs, 3Q 2020

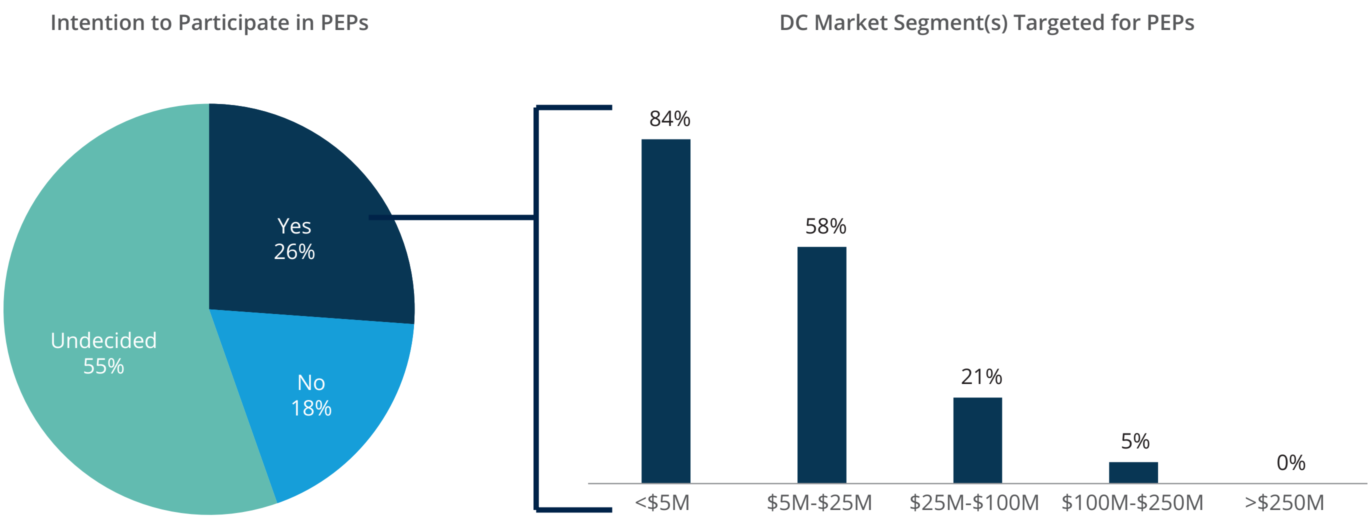
Many recordkeepers are taking a "wait and see" approach to PEPs, and fewer than one in five are committed to acting as a PPP.

Statement	% of Recordkeepers
We will consider entering the PEP market if we are approached by existing clients or consultants/advisors	39%
We are actively pursuing Association Retirement Plan (ARP) business	33%
We are not planning to enter this market in the next two years	28%
We will consider servicing ARPs if we are approached by existing clients or consultants/advisors	22%
We are actively pursuing PEP business and plan to act as a Pooled Plan Provider in the next two years	17%
We are pursuing PEP business as a recordkeeper only, not as the Pooled Plan Provider or other named fiduciary	11%
Other	11%
We are actively pursuing PEP business and plan to act as a plan sponsor in the next two years	6%

Sources: Cerulli Associates, in partnership with The SPARK Institute | Analyst Note: "We are actively pursuing PEP business and plan to act as a co-fiduciary other than the PPP, for example, as a 3(38)" was an option but was not selected. "Other" includes: "We are actively pursuing PEP business, but carefully, considering the fiduciary requirements associated with the new regulations" and "if the recent DOL RFI includes an expansion of the prohibited transaction rule, further consideration of PEPs may be necessary."

Registered Investment Advisors' Outlook for PEPs, 3Q 2020

Close to one-quarter of RIAs have decided to offer PEPs, and advisors generally perceive PEPs as a solution for the micro-to-small plan market.



Sources: Cerulli Associates, in partnership with DCIIA and TRAU | Analyst Note: 1) Only respondents who answered ""Yes"" to "Are you (your team) planning to offer a Pooled Employer Plan (PEP)?" were asked, "Which DC market segment(s) will you (your team) target when offering PEPs?" 2) This survey targeted advisors with significant retirement plan business, at least $100M in DC assets under advisement (AUA) for individual advisor practices or $200M in DC AUA for advisory teams."

Cerulli posits that recordkeepers and third-party administrators (TPAs) with existing MEP business are a logical fit to accommodate these plans, but many providers have taken a "wait and see" approach. In Cerulli's survey of DC recordkeepers, conducted in 3Q 2020 in partnership with The SPARK Institute, about half of respondents perceive MEPs/PEPs as a moderate or significant growth opportunity. Only a handful intend to act as a PPP, but more are open to the idea of entering the PEP market if approached by existing plan sponsor clients or their consultant/advisor partners.

In the meantime, recordkeepers are just as inclined to target Association Retirement Plans (ARPs), another flavor of MEP; about one-third of respondents indicate they are actively pursuing this business. In July 2019, before the Senate's passage of the SECURE Act, the Department of Labor (DOL) announced a rule expanding access to ARPs. The rule specifically allows for employers—including sole proprietors—in the same city, state, or metropolitan area to participate in an ARP.

In conversations with Cerulli, some recordkeepers express hesitation when it comes to the PEP service model. One research participant explains that their firm's engagement with PEPs will depend on the DOL's Prohibited Transaction Exemptions. Other providers are leery of having to register as a PPP with the DOL (and furnish detailed disclosure information), the complexity of reporting requirements, or the potential for lengthy audits. According to one recordkeeping executive, "We've already had success providing low-cost solutions in partnership with TPAs...it's hard to see how PEPs would expand coverage or lower cost."

With economy of scale comes the potential for reduced fees, and PEPs have been touted as a cost-saving measure. That said, it remains to be seen how their price point will compare with single-employer solutions aimed at the small plan market. With all the different provider roles at play in a PEP—from the PPP/3(16) administrator to the 3(38) fiduciary in charge of investment selection, recordkeeper, and independent trustee—multiple layers of involvement will likely drive up total cost. Some stakeholders worry this situation could create a dynamic of "winners" and "subsidizers" within a given PEP, prompting (relatively) larger employers to maintain individual plans instead. Providers anticipating a winner-take-all landscape may come to market with aggressively priced/subsidized solutions in an effort to quickly establish a presence in the PEP market and build scale.

Advisors may be reticent to cannibalize their more lucrative single-employer plan business.

On a related note, a recent paper authored by a Boston College professor and published in the *Journal of Corporation Law* suggests that fees in existing MEPs are substantially higher than for similarly sized single-employer plans. The DC marketplace is notoriously fee-sensitive and fiduciary-aware, and 2020 proved to be a busy year for class action ERISA lawsuits, many of which take aim at administrative or investment-related fees. Traditionally, these lawsuits have targeted "mega" 401(k) plan sponsors with at least $1 billion in assets; however, Cerulli notes a trend of litigation extending downmarket to somewhat smaller plans, 403(b) plans, and also MEPs (see *The Cerulli Edge—U.S. Retirement Edition 3Q 2020*).

In this context, providers (*e.g.*, plan administrators, consultants) are typically the named defendants. The law firm Schlichter Bogard & Denton, well-known in the arena of retirement plan litigation, filed one such case against ADP TotalSource in May 2020. This was followed by a case against Pentegra Retirement Services in September 2020, signaling that multiple-employer arrangements like MEPs and PEPs may represent a more significant area of focus for lawsuits going forward.

As for advisors, slightly more than half of registered investment advisors with significant retirement plan business remain undecided about whether to offer PEPs. More than one-quarter (26%) have decided to serve this market in some fashion, but few are committed to acting as the PPP. Advisors tend to view PEPs as suitable for the micro-to-small plan segments, but none perceive this as a solution for large ($250 million+) plans.

Large plan sponsors often maintain more complex plan design characteristics, including special provisions for legacy groups from mergers and acquisitions, which creates a challenging backdrop for migration to a PEP. Just as importantly, advisors may be reticent to cannibalize their more lucrative single-employer plan business. Some providers comment that even plan sponsors keen to join a PEP in theory may underestimate the effort associated with fully terminating a plan, while suggesting that PEPs could still present an attractive solution for newly eligible participants moving forward.

Along with Aon, a handful of other advisor/consultant intermediaries have announced their intention to offer PEPs. Lockton Retirement, for example, recently created an "outsourced administrative responsibilities" practice in charge of launching PEPs, starting in the Northeast. The solution designates NPPG Fiduciary Services as the PPP, with Pinnacle (an NPPG company) acting as a third-party administrator and Transamerica as the recordkeeper.

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