Fiduciary Protection for Employers Who Adopt PEPs

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While Pooled Employer Plans (PEPs) offer a number of advantages to employers who adopt them, perhaps the best known is the transfer of most fiduciary responsibility and potential liability from the employer to the PEP's primary fiduciary—the Pooled Plan Provider (PPP). However, not every PEP arrangement offers the maximum transfer of that responsibility. This article discusses the approach that employers should take to transfer the most fiduciary responsibility, and potential liability, as possible.

ERISA section 3(43)(B) explains which responsibilities can be transferred and which must be retained by an employer. In essence, it says that an adopting employer must, as a fiduciary, prudently select and monitor the PPP and any other named fiduciaries. It goes on to say that, unless the PPP appoints an investment manager (referred to as a 3(38) investment manager) to select and monitor the PEP's investments, the employer retains fiduciary responsibility for the investments.

With that background, let's look at how the rules work and what an employer can do to transfer the most of those responsibilities.

SELECT AND MONITOR THE PPP

This is the primary responsibility of an adopting employer. To satisfy ERISA's fiduciary requirements, employers should, at a minimum, look at these factors:

Is the PPP experienced in the management and administration of retirement plans as a 402(a) named fiduciary?

Do they have experience with the responsibility of selecting and overseeing service providers and investment managers (sometimes referred to as a 402(a) named fiduciary)?

An employer should look for significant historical involvement in the retirement world and consider the nature of the PPP's experience with plan management, plan investments and plan administration. As a part of that, employers should ask for and obtain information about any lawsuits or governmental investigations into the PPP's conduct.

Is the PPP a regulated financial institution?

Regulated firms—such as banks, trust companies and insurance companies—are subject to government oversight which provides greater safety for adopting employers.

Is the PPP financially able to handle any claims or lawsuits that may be filed for alleged fiduciary breaches (or is it adequately insured for that purpose)?

Unfortunately, fiduciary lawsuits are a part of the retirement plan world. When allegations are the PEP's service providers not doing their jobs properly or being overpaid from plan assets, the primary claim will be against the PPP, and if the PPP is able to pay the costs of defense, settlement and/or judgment, there is little likelihood that the employers will need to contribute to a settlement or judgment. When the allegations are that the 3(38) investment manager imprudently selected or monitored the PEP's investments, the primary claim would most likely be against the 3(38) investment manager, and the secondary claim would typically be that the PPP did not prudently select or monitor the investment manager. In both cases, there would be little, if any, need for the plaintiffs' attorneys to attempt to obtain damages from the adopting employers where the PPP and the investment manager were financially able to pay for the defense costs and cover any settlement amounts or judgments.

Is the PPP a viable, long-term organization?

401(k) plans can exist for long periods—decades—and for larger companies, even longer. The PPP should be structured for longevity, with clear succession plans, so that the PPP will be around to manage and administer the plan for the indefinite future.

Legal Note

ERISA has three distinct types of fiduciaries. Simply stated, those are a person or entity that: (i) exercises authority or control over the management of a plan or the disposition of its assets; (ii) provides investment advice for compensation; and (iii) has discretionary responsibility for the administration of the plan. The PPP is, by law, the first and third of those. It controls and administers the PEP. The PPP may delegate some of those responsibilities, but it is responsible for doing so in a prudent manner and then monitoring that the job is being done properly. For example, ERISA says that the PPP is the 3(16) administrative fiduciary, but it can contract with a third-party administrator to help with that job (or it can retain those responsibilities). And, where the PPP appoints a 3(38) investment manager, the second category—investment advice—is also managed by the PPP and is not the responsibility of an adopting employer.

SELECT AND MONITOR THE OTHER NAMED FIDUCIARIES

While an adopting employer has a legal responsibility to monitor the other named fiduciaries, its role is secondary if the PPP assumes this responsibility in both the PEP design and any service agreements. When that is the case, the PPP selects the other named fiduciaries—for example, the trustee, a 3(16) third party administrator and the 3(38) investment manager—and must prudently select and monitor them. As a result, adopting employers should ensure that the PPP agrees it has that primary responsibility and it will report, at least annually, to the adopting employers about its review of those fiduciaries.

Comment

While the law contemplates that, in order to provide the greatest transfer of fiduciary responsibility, the PPP must have those responsibilities, some PEPs and PPPs transfer the responsibilities back to the adopting employers in the service agreements. As a result, employers who are considering adopting a PEP should make sure that the PPP agrees that it has the fiduciary responsibility for the selection and monitoring of the other fiduciaries and service providers. Adopting employers should also make sure that the PEP agreements do not attempt to shift that responsibility back to them.

SELECT AND MONITOR THE INVESTMENT MANAGER

Adopting employers can effectively shift the fiduciary responsibility for the PEP's investments if, and only if, the PPP appoints a 3(38) investment manager to select and monitor the plan's investment lineup. The PPP should also have the job of monitoring the investment manager. If designed that way, the fiduciary responsibility and potential liability for the plan's investments are shifted to the investment manager.

Comment

Employers who are considering a PEP should—if they want to shift the investment responsibility—ensure that the PPP will select and monitor an investment manager. Some PEPs put that responsibility on the adopting employers, which reduces the fiduciary protections for those employers. In those cases, the investment manager will usually have each adopting employer sign an investment advisory agreement—meaning that the employer is a fiduciary for the selection and monitoring of the investment manager. If the employers do a good job of selecting and monitoring the investment manager, they will be protected from bad investment decisions by the investment manager, but even then, the employers could be sued on the theory that they did not satisfy the fiduciary duty to monitor the investment manager.

SELECT AND MONITOR NON-FIDUCIARY SERVICE PROVIDERS

Participant-directed plans, such as 401(k) plans, require the services of a number of providers, some of whom are fiduciaries and some of whom are not. As with fiduciary providers, the PPP selects and monitors the non-fiduciary providers. For example, participant-directed plans need recordkeepers to provide administrative services, such as allocating contributions and earnings to participant accounts and to provide various compliance documents. In some cases, the PPP also serves as the recordkeeper, but in others the PPP hires a third party recordkeeper.

Where the PPP engages a third party recordkeeper, the PPP has the fiduciary responsibility to determine the quality and costs of the recordkeeper on an ongoing basis. However, where the PPP also serves as the recordkeeper, the costs may be embedded in the PPP's fees and the PPP may, in effect, be monitoring itself. In that case, adopting employers should determine whether the recordkeeping fees, as well as the rest of the PPP's fees, are reasonable. In addition, adopting employers should periodically review whether the recordkeeping services are of good quality and responsive to the needs of the adopting employers.

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CONCLUDING THOUGHTS

PEPs can provide significant fiduciary protections for employers who adopt 401(k) and private sector 403(b) plans. Those protections can extend beyond lawsuits to encompass DOL and IRS investigations.

However, not every PEP offers that full range of fiduciary protections. As a result, employers may be on their own when it comes to understanding the rules and carefully reviewing a PEP's contractual provisions. Fortunately, experienced retirement plan advisers can help with that job.

The bottom line is that, if an employer wants to adopt a PEP and have the greatest possible fiduciary protection, the employer must: (i) select a PPP that has the experience and financial wherewithal to provide high quality, reasonably priced, long-term services; (ii) select a PEP that has a 3(38) investment manager selected and monitored by the PPP; and (iii) carefully review the service agreements to ensure that none of the PPP's or 3(38)'s responsibilities have been transferred back to the employer.

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Let's talk.

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