Have A Small Plan Or Forced To Offer One? Consider Joining A 401(k) PEP

By Ary Rosenbaum, Esq.

Having a small plan like a SEP a SIMPLE or a Solo 401(k) Plan may make sense from a financial standpoint. The problem is like I felt when I was an associate attorney at some "fakakta" (my favorite Yiddish word) Long Island law firm: you're left to die. That's why I suggest plan sponsors with small plans consider joining a Pooled Employer Plan (PEP). This is what this article is all about.

There is always a trade-off in using a small plan.

Whether you adopt a small business retirement plan or even a qualified plan such as a 401(k), there is always a tradeoff. To take advantage of tax-deferred retirement savings for plan participants and tax deductions for businesses for making employer contributions, there are certain compliance rules that you must abide by to get that preferred tax treatment. Small business plans offer advantages over qualified plans such as almost no administrative costs, but there is a tradeoff that we will certainly explain. Small business plans such as a Simplified Employee Pension Individual Retirement Arrangement (SEP IRA) Savings Incentive Match Plan for Employees' Individual Retirement Account (SIMPLE IRA) or a Solo 401(k) Plan are free in the point that there is no administrative expense, have almost no compliance, no Form 5500 to file (unless the Solo 401(k) Plan has $250,000 or more in assets), and the controlling plan document is given away for free by the custodian (usually a mutual fund company or brokerage firm) that offers it. The problem is that there is a cost to you for this free plan.

Zero Help, Zero Special Features

They say that you get what you pay for and that is often the case when you adopt one of these "free" plans. Since the plans require little or no administration, these plan custodians would provide you with very little administration help because administration help does cost money. In addition, you aren't likely to get any financial guidance since plan custodians that offer these small plans are only getting compensated on the assets. While the fiduciary liability of setting these plans up is far less than other plans fully covered under ERISA, a lack of financial guidance to plan participants will likely mean fewer retirement savings because participants who get financial guidance have a far higher rate of return than those who don't. Plan sponsors like you, usually have little knowledge of how retirement plans work, so having no help endangers them. The beauty of qualified retirement plans is the ability to allow features to suit the needs of your role as a plan sponsor. The flexibility is needed because you might have different demographic and financial needs. The problem is that these small plans have no flexibility. If you have employees other than a spouse, you can't use a Solo 401(k) and would have to choose a SEP that has no deferrals or a SIMPLE Plan that has a lower deferral limit. If you have union employees, SEPs and SIMPLE-IRAs would require these employees to be covered even though any qualified plan would allow the plan sponsor to make them ineligible as plan participants. SEPs and SIMPLE IRAs also don't allow plan loans or hardship distributions that participants may need during times of financial stress. There are two problems with employer contributions with these smaller plans: one is uniformity and the other is manda-

tory. When it comes to retirement plan design, some features allow for a disparity in contributions between highly paid employees and lower paid employees where highly paid employees can get a higher rate of contribution. This can be through a contribution based on the Social Security Wage Base, age, or a cross-tested allocation where participants are split into groups and each group can get a different allocation. The problem is that SEP-IRAs and SIMPLE-IRAs require that all contributions are uniform across the board, based on the same percentage of compensation. Another problem is that SIMPLE-IRAs have a required contribution, which you may not have to make with a larger, qualified plan.

PEP, what's it all about?

A PEP is (1) an individual account plan (2) established or maintained by a "Pooled Plan Provider" to provide benefits to the employees of two or more employers, and (3) a plan described in Section 401(a) of the Internal Revenue Code of 1986, as amended (the Code) or which consists of individual retirement accounts under Code Section 408, and (4) includes certain specified terms in its plan document. The push for PEPs is the idea that the promulgation of this type of plan will get smaller employers to offer a retirement plan for their employees through a PEP, that they might not have offered on their own. More importantly, it relieves an employer who joins the PEP because of the use of a PPP. A PPP has several requirements such as: (1) The PPP is designated by the terms of the PEP plan document as the named fiduciary, the plan administrator, and the person responsible for performing all administrative duties (to make sure the PEP abides by ERISA and the Internal Revenue Code; (2) Before beginning operations as a PPP, the entity registers with Treasury and the DOL and provides such information as Treasury and the DOL may require; (3) The entity acknowledges in writing that it is the PEP's named fiduciary and plan administrator; and (4) the entity is responsible for ensuring that all persons who handle plan assets, or otherwise plan fiduciaries, are bonded per ERISA Section 412.

Why Join A PEP?

When it comes to marketing, you need to delineate between the sizzle and the steak. When it comes to PEPs, cost savings is the sizzle. It's the biggest point that most plan providers will stress and fail to deliver. As a 401(k) plan sponsor or potential sponsor, you should focus on the steak of PEPs. The steak of PEPs is fiduciary delegation where you take your fiduciary liability of running a plan and delegating that authority and the problems that go with it, to the PPP. Being a 401(k) plan sponsor is a tough and thankless job. More importantly, you don't have the background or training to be a fiduciary, it's a job foisted on you because of your role as a retirement plan sponsor. The PEP will allow you to delegate that thankless job to the PPP. Also, the PEP frees you from ever filing a Form 5500 every year as the PEP files one 5500 for the entire plan, regardless of the number of employers that are part of a PEP. The PPP is responsible for Form 5500, the delivery of notices, and the hiring and firing of plan providers. Treat the PEP as a concierge service, where you join a PEP and hire a PPP to do all the work you would have ordinarily done. As stated before, hiring a PPP is a fiduciary decision and you need to choose one wisely. There could be some questionable people who act as a PPP, so vet the individual or company serving in that role. The PPP will hire a financial advisor, so unlike the small plan world, you and your participants are left to die.

Forced into offering a plan? A PEP might be a great idea.

Both the Federal and state governments are concerned about retirement plan coverage and that many private employers don't offer one. Therefore, a lot of state and local governments have required employers to offer a plan of their own or become part of a government-run SIMPLE-IRA plan. The problems with joining a SIMPLE-IRA plan are that you would be participating in a state-run program (there is a wariness of joining a government-run plan) and as discussed, the retirement savings limits are way less than what you can offer under a 401(k) plan. Would you rather work with a PEP than the state? That's your call. If you're forced to offer a 401(k) plan, why not offer a 401(k) plan under a PEP?

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