Mind the Coverage Gap

By Kerry Pechter *Thu, Jul 26, 2018*

'I am not aware of any predictions that a significant percentage of small employers who do not currently offer a plan will now adopt a PEP,' said Jack Towarnicky, executive director of the Plan Sponsor Council of America, when asked if multiple employer plans will close the 401(k) 'coverage gap.'

Would "open multiple employer plans" (MEPs) or "pooled employer plans" (PEPs) encourage thousands of small employers to offer their workers a retirement plan for the first time?

Or would these umbrella 401(k) plans, which plan recordkeepers, payroll companies and outsourced fiduciaries create and invite employers to join, mainly recruit and enroll employers that already offer plans?

More to the point: Would these relatively new types of plans significantly shrink America's coverage gap—the fact that about half of full-time private-sector US workers lack a tax-deferred savings plan at work—or would they just rearrange and "cannibalize" existing market share?

In lobbying Congress to remove the legal barriers to MEPs and PEPs, major retirement firms and their advocacy groups have insisted that these plans will reduce the coverage gap. That argument didn't sway the Obama administration, which preferred public remedies for the gap, such as a nationwide system of auto-enrolled IRAs called MyRAs or state-sponsored programs.

But the Trump administration appears receptive to an industry-led solution to the under-coverage problem. It axed the MyRA plan, and a top Labor Department appointee is the former Republican Senate aide who in 2016 wrote one of the pending proposals that could enable more open MEPs and PEPs. It remains to be seen if any of those proposals will become law.

For this installment of *RIJ*'s series on provider-sponsored 401(k) plans, we talked to several people with strong opinions regarding the questions posed above. The answers suggest that there probably will be some cannibalization and some growth in coverage. An industry-led solution is likely to close the coverage gap where it makes business sense to do so, but not necessarily in the areas of greatest need.

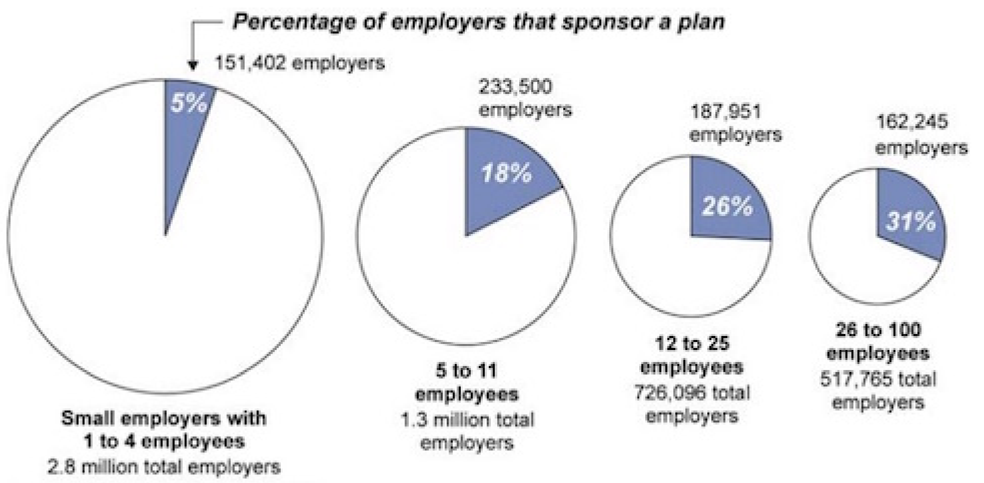
'No consensus'

Troy Tisue, the CEO of TAG Resources, Inc. of Knoxville, Tenn., which provides outsourced fiduciary services to clusters of small plans, is well-positioned to comment on MEPs. He claims to have started the open MEP movement in 2002, after an IRS **ruling** confirmed the tax-favored status of certain umbrella 401(k) plans.

Often partnering with Transamerica as plan recordkeeper, TAG Resources began setting up such plans. His business model attracted imitators, and the field slowly grew. In 2012, after the Department of Labor declared that companies in an umbrella plan must have some "nexus" or commonality, he and Transamerica tweaked their model so that each employer in the plan filed its own Form 5500, a dreaded piece of essential red tape.

Asked about the issue of cannibalization versus coverage expansion, Tisue told *RIJ*, "40% of the plans we write are dead start-ups." That is, about 60% of the employers he recruits already have plans. New employers join a Transamerica/TAG umbrella plan either because it lets them start up a plan for less or because they want to transfer most of the risk of being sued (for making a mistake in choosing investments or handling participant money) to an outside fiduciary.

Figure 1: Small Employer Plan Sponsorship by Number of Employees in 2009



Source: GAO analysis of Labor and IRS data.

"Everyone has an innate fear of doing something wrong. That's why the employer wants delegation [of the plan watchdog or 'fiduciary' role]," Tisue told *RIJ*. Asked if he had ever detected pent-up demand for 401(k) plans among the employers or employees at small companies that don't currently offer plans, Tisue couldn't say.

A 2012 Government Accountability **study** showed no clear evidence that MEPs would shrink the coverage gap. "Overall, no consensus existed among MEP representatives and pension experts on whether or not MEPs such as PEO MEPs or open MEPs would substantially expand pension coverage," the GAO report said.

"Several MEP representatives thought that MEPs had the potential to expand coverage, especially among small to mid-size employers that could benefit from the potential administrative and cost advantages. However, a couple of pension experts were skeptical that open MEPs would have much of an impact in expanding retirement plan coverage. For example, one pension expert said employee demand, rather than cost benefits offered by MEPs, drives whether or not a business sponsors a plan.

"While a couple of the MEPs we spoke with had offerings for employers to start new plans through the MEP, several targeted businesses with existing plans. For example, an open MEP representative said their adopting employers usually have over 100 employees or plan assets of $2 million to $5 million," the report said.

"We, like GAO, found that open MEPs are not coverage solvers, but rather an attempt to offer a product with fewer restrictions," former chief of the DOL's Employee Benefit Security Administration (EBSA) Phyllis Borzi told *RIJ*. "It was a deregulation thing, because employers who had established 401(k)s would now be out from under their fiduciary burden.

"The industry would be cannibalizing its existing 401(k) business, so there would be no overall increase in coverage. So the Obama administration was not supportive it. We did talked about a version of open MEPs in the budget, but these could only be used or marketed however to employers who hadn't had a plan for three to five years."

Industry voices

Industry views are softer. "On the question of cannibalization, it's not a matter of 'either/or,'" said State Street Global Advisors' managing director for public policy, Melissa Kahn, in an interview. "There might be some cannibalization. But for most part [open MEPs] will bring more people into the system. In Oregon, for example, they have a coverage mandate, and a lot of employers are voluntarily enrolling in plans even before they are forced to."

Lori Lucas, president and CEO of the Employee Benefits Research Institute (EBRI) told *RIJ*, "We often hear that the burdens of offering retirement plans outweigh the merits. [Plan sponsors] cite the 401(k) litigation and lawsuits. They would eagerly move away from [direct plan sponsorship] if the system facilitated it. They would look at a widely accessible open MEP system as a way out of the traditional system. That would be a completely different dynamic. It would begin to cannibalize the industry."

Jack Towarnicky, executive director of the Plan Sponsors Council of America and who sponsored a MEP among affiliated companies for 25 years, does not predict that open MEPs or PEPs will be the answer to the coverage gap.

"A PEP does enable small employers to band together, to qualify as a single plan, and to achieve a modest reduction in costs through simplified annual reporting and audit relief," he told *RIJ* in an email. "Those savings may be substantial for small employers who have already adopted a plan."

He added, in contradiction of some claims that PEPs will reduce plan costs significantly, that PEPs "may not change the cost calculation for those employers who have not adopted a plan. I am not aware of any predictions that a significant percentage of small employers who do not currently offer a plan will now adopt a PEP."

Sharp sticks, plump carrots

Government statistics, albeit dated, showing that the larger the firm, the more likely it already offers a plan today. In 2009, only 31% of the half-million firms with 26 to 100 employees offered plans and 26% of the 725,000 firms with 12 to 25 employees offered plans. That's where the opportunity for MEPs might be concentrated. The millions of firms smaller than that would be too insignificant for private firms to spend marketing dollars on. To the extent that they employ low-income workers, however, they become a concern of public policymakers.

No matter how cheap and easy providers make it to offer a plan, employers currently without plans wouldn't necessarily jump into a pooled plan. Low-cost, low-friction ways to offer 401k plans or SIMPLE IRAs already exist for employers who are altruistically inclined to do so, or who want the tax breaks that go with offering plans, or who feel pressure from employees. States like California and Oregon are proceeding with state-sponsored plans on the assumption that it will take a mandate or at least a nudge to achieve universal 401(k) or IRA coverage within their borders.

“I like the idea of state- or large city-sponsored open MEPs, because you have experts, acting in the public trust, making critical decisions about plan design,” said Nari Rhee, director of the Retirement Security Program at the University of California–Berkeley. “They also command some market power to drive down fees on behalf of participants, and they’re more likely to reach scale. So far, the one in Massachusetts for nonprofits seems to be decent.”

“It’s no accident that most countries have gone to a mandatory DC system,” Borzi told *RIJ*. “You can’t have sharp enough sticks or plump enough carrots to get to the goal of universal coverage. But in the U.S. we’re not close to a mandatory system.”