'PEP' Talk

By Kerry Pechter *Thu, Aug 2, 2018*

In this sixth installment of our series on "pooled employer plans" or PEPs (also known as "open multiple employer plans" or MEPs), we asked 401(k) experts if this new type of workplace savings plan would in fact be cheaper to run than current plan options, and would therefore entice more small employers to begin offering plans to their employees. There was no simple or definitive answer.

Advocates of legislative proposals that would allow the creation of so-called PEPs—pooled employer plans—say that these provider-sponsored, multiple employer plans will encourage more small employers to offer 401(k) plans.

PEPs will accomplish that in several ways, they say: Above all, by removing most or even all of the legal liability that reportedly scares so many employers away from sponsoring federally-regulated plans; by reducing their administrative chores; and by reducing the notoriously high costs of offering a micro-size plan to the low costs enjoyed by participants in "jumbo" plans.

But, on that last point: it hasn't been proven that PEPs would in fact save small company owners and employees a lot, relative to the cost of other available retirement plan options. "Small employers will get the benefits of scale, but joining a PEP won't cut their costs in half," Pete Swisher, national sales director at Pentegra Retirement Services and author of *401(k) Fiduciary Governance*, told *RIJ* recently.

"The raw cost of providing a plan isn't dramatically cheaper in the multiple-employer plan. It might take the cost of setting up a 401(k) from a $6,000 thing and turn it into a $5,500 or a $5,000 thing. But it's not going to turn it into a $1,000 thing," Swisher added;

Certain parts of the retirement industry are pushing hard for changes in pension law that would allow providers to sponsor PEPs and invite employers to join. Such arrangements, if widespread, could alter the economics and dynamics of the 401(k) business. Large providers could aggregate the assets of many small plans into pools large enough for them to serve economically. The providers might also offer financial wellness programs to participants in many small plans.

Through wellness programs, they could market emergency spending accounts, health care savings accounts, college savings plans, student debt management services, and perhaps even annuities. At a time when the actual costs of recordkeeping and investment options are falling (to near-zero, in the index fund business), large providers need new markets, a broader array of products, and a chance to capture IRA rollovers when employees leave plans or retire.

“Our strategy is to expand the footprint around the broader issue of financial wellness,” Harry Dalessio, head of Full Service Solutions at Prudential, told *RIJ* in an interview.

In this sixth installment of our series on MEPs and PEPs, we asked 401(k) experts if multiple employer plans would in fact bring lower costs to small employers and small-plan participants. There was no brief or easy answer. On the one-hand, small employers who currently offer high-cost plans could see lower costs in a pooled plan.

It’s true that many small companies still have high-cost plans with expensive investment options that financial advisors sold them long ago. But streamlined, low-cost, low-maintenance 401(k) plans are readily available to small employers today. And some suggest that the cost of keeping records for a dozen or more different small employers could be more complex and therefore more expensive than keeping records for a single plan.

Raw cost of a plan

“The assumption is that multiple employer plans must be about scale and cost-savings, but that’s not what they have to be about,” Swisher said. “We already have an example of a scaled-cost model with Vanguard. Vanguard went to Ascensus to be its recordkeeper for small plans, and they set up a couple of thousand plans a year. Ascensus offers a discount for that. Ascensus was already inexpensive and it became 5% or 10% less expensive. But that in itself is not transformative.

“If that’s all it was about, you don’t need a MEP for to achieve that. The base cost of that work, not the price but the cost, is $4,000 to $6,000. If you’re a micro-business, you don’t want to write a $4,000 check, or even a $2,000 check. A MEP will help with the effort, and a little bit with the cost,” he told *RIJ*.

“Everybody seems to think that you can divide that $4,000 by 100 and bring it down to $40. No, you can’t,” he said. “There are practical and legal obstacles. Each employer has to have compliance tests done individually, non-discrimination tests. These are tests that have to be done employer by employer. Each employer will have payroll costs. And there are problems that come with processing the different payrolls.”

MEPs "won't lend themselves to being the cheapest solution [for employers who want to offer a retirement plan to employees]" he added, because they will be monitored by professional fiduciaries who will make sure that the job is done in the best possible way, not in the cheapest possible way.

Jack Towarnicky, executive director of the Plan Sponsor Council of America, agrees.

"A PEP's small size and its significant flexibility would not necessarily reduce costs, introduce economies of scale/value add, nor lower fiduciary exposure – given the number of small employers in a PEP plan, the different payroll schedules and frequencies which complicate processing, the ability of each participating employer to select a diverse set of investments from a fund lineup – all coupled with numerous other differences in plan design and administration," he told *RIJ*.

A veteran in the PEO plan space (PEO stands for professional employer organization, or employee-leasing company) told *RIJ* that it's not necessarily cheap and easy to run a multiple employer plan if the companies in the plan don't use the same payroll firm.

"We benefit from great efficiency in the PEO space because we get a single payroll feed from dozens or hundreds of companies," said Justin Young, marketing director at **Slavic401k**. "But I still have to deal with thousands of individual companies on plan setup, contribution remittance, and processing and payroll issues. Someone will have to crack the code, otherwise recordkeepers will have to charge a lot more to run an open MEP."

Slavic401k charges its clients a combination of asset-based and per capita fees, he said. It charges $39 per year per participant, plus a tiered asset-based fee that goes down as the adopting employer's plan grows in assets.

A refuge for the asset-based fee model?

"For recordkeepers, it won't be easy," said Eric Droblyen, president and CEO of Employee Fiduciary, a third-party administrator of small 401(k) plans whose business could be threatened by the spread of MEPs.

"You have vesting, reconciliation to a single trust. You could have hundreds of different employers. My company could offer a multiple employer plan, but why would we? You're not going to buy better investments. If you're looking at plans priced on an asset basis, then yes, it's a way to drive down costs. But that's only if you're married to the asset-based pricing model. Assets have almost nothing to do with the expenses of a 401(k) provider."

Droblyen called open MEPs "the last gasp of asset-based pricing." To him, they may make sense to large asset managers, but only in a world where larger pools of assets translate into larger revenues. He believes the 401(k) world must evolve toward per capita pricing, because it doesn't place a disproportionate portion of the plan costs on participants with large accounts.

"You might have a 10-participant plan where one employee's account is worth $10,000 and the company owner's account is worth $1 million. The recordkeeping is just as difficult for one as the other. But with asset-based pricing, participants with high account balances are getting rolled."

Others agree. "Honestly, if you're paying 50 basis points (0.50%) for recordkeeping and you have $1,000 in your plan and your fee is $5 and I have a million in the plan and I pay $5,000, that is not equitable. Sooner than later the industry as a whole will have that epiphany and we'll make a massive move to per capita pricing," said Justin Young of Slavic401k.

"Guideline, for instance, charges $8 per participant and that's charged to employer, it's an all index lineup, and 8 basis points for the investments," he added. "We look at that and say that's extremely aggressive. But if were really in this for the best interest of the participant, that's the best thing for the participants. But that would be hard pill to swallow [for plan recordkeepers and asset managers]."

Absence of a mandate

Pete Swisher believes that the private 401(k) industry has all the tools needed to bring 401(k) plans to small companies, and doesn't believe that the federal or state governments need to sponsor umbrella plans, he does believe that a government mandate requiring all but the smallest employers to offer plans to employees might be necessary if the country hopes to reach universal 401(k) coverage.

"If there is a genuine need and the market has failed to meet it, then you have a prima facie case for government intervention," Swisher said. "We don't have a market failure so much as an absence of motivation. There are structures today whereby small employers could have plans. What's missing is the cause for them to get out and do it. "It's the absence of a mandate that's the problem, not the absence of a product. The state programs will give a governmental stamp to stuff that's already out there. I think public options will offer competition, I think people will still want help from advisors… that's been the industry belief from early… the upshot is that the government will probably capture just a small part of the business. I'm not a doom-and-gloomer. If anything, I'm a take a glass three-quarters-full view."

James Holland, of MillenniuM Investment and Retirement Advisors in Charlotte, NC, agreed that legislation alone won't ensure that all American workers have a retirement plan. "The big push behind this is based on the idea is that if we just change the rules, somehow it will fix the problem. That doesn't address the many employers who are unengaged or apathetic," he said.

"You can lead people to water, and even give them a cup, but that doesn't mean they will drink from it. I'm not anti-MEP guy by any stretch of the imagination, but this [legislative] proposal is far from a magical elixir. You can't legislate this problem away. It as to be solved by the people involved—the plan sponsors, the advisors and the participants."