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Pooled Employer Plans (“PEPs”): Putting a little *PEP* in a 401k retirement plan could help to protect your Portfolio Companies

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Set against the backdrop of the continuing wave of ERISA litigation that is being brought against employers who sponsor retirement plans, Pooled Employer Plans (“PEPs”) are emerging in the US retirement plan marketplace as an alternative that may limit employers’ risk of retirement plan-related litigation. There have been over 220 ERISA class action suits filed in connection with retirement plans since 2018, and the top ten ERISA settlements for 2021 alone totaled $840 million in the aggregate. Since ERISA litigation is a serious and relevant concern, many plan sponsors, including private equity sponsors and their portfolio companies, would benefit from evaluating whether a PEP is a viable retirement plan solution for them.

Many of the salient attributes of PEPs appear to align with the priorities of our private equity clients’ portfolio companies as they navigate transactions and work to streamline operations. PEPs are still relatively new, but our benefits consulting group has been closely monitoring the PEP market and can provide guidance and insight on which PEPs might best align with the specific needs of your portfolio companies.

Overview of Pooled Employer Plans

PEPs were established by the SECURE Act legislation and were rolled out January 1, 2021. At a high level, a PEP is a multiple employer defined contribution retirement plan (i.e. a 401(k) plan that allows unrelated employers to participate). A PEP is sponsored by a third party (rather than the employer), called a *pooled plan provider*.

Under a PEP arrangement, a portfolio company would not sponsor its own plan—instead, it would be a “participating employer” that outsources most of its ERISA fiduciary responsibilities, as well as the burden of retirement plan management and administration, to the PEP. This is of significant importance, since much of the current ERISA litigation is brought against employers who are cited for inadequate ERISA fiduciary oversight of their retirement plans.

PEPs are now being offered by many of the retirement plan record-keepers, consulting firms, payroll providers, and benefits administrators who have established PEPs and have registered as pooled plan providers with the DOL.

Why Private Equity Firms / Portfolio Companies May Want to Consider PEPs

In addition to managing ERISA fiduciary litigation exposure, PEPs have the potential to offer the following advantages to employers and their plan participants when compared to traditional single-employer 401(k) retirement plans:

- Participant Fees – Due to economies of scale, PEPs generally have lower recordkeeping and administrative costs compared to smaller single-employer retirement plans. Many of the ERISA litigation class action suits revolve around excessive participant fees.

- Shift ERISA Fiduciary Responsibilities – PEPs allow employers to shift the majority of their ERISA fiduciary responsibilities (e.g., monitoring the menu of investment options, management of retirement plan administration and investment management) to the PEP and its providers.

- Reduce Plan Administration Management – The PEP’s pooled plan provider takes on most of the day-to-day plan administration from the employer. The pooled plan provider is responsible for plan documentation, required governmental filings, and ongoing plan compliance, which reduces the amount of resources an employer needs to allocate to benefits administration.

- Reduce Vendor Relationships – Typically, for single-employer retirement plans, a company will need to engage with a record-keeper, custodian, investment advisor, trustee, auditor, and possibly an actuary. These additional engagements can be costly – for instance: an investment advisor can cost an employer or retirement plan an additional $50,000 to $250,000 a year based on size. Under a PEP, all of these services are bundled with one provider, offering economies of scale.

Private Equity Sponsors, Transactions, and PEPs

Although the ultimate decision as to whether to participate in a PEP must be evaluated and decided upon by each individual portfolio company, PEPs may provide practical advantages for private equity sponsors in connection with transactions.

For private equity sponsors on the buy-side of a transaction, PEPs appear to have the following advantages:

- Implementation Time – Typically, PEPs can be implemented more quickly than single employer retirement plans. Given the trend of condensed timing between sign and close, PEPs serve as a viable option that may allow private equity sponsors to avoid unnecessary transitional service agreement fees while ensuring that a retirement plan can be set-up as of closing.
- Carve-outs – PEPs have been increasingly popular for carve-outs.
    - Participant Fees – Employees being acquired in a carve-out from a larger employer are typically accustomed to fairly low retirement plan fees --- a PEP is more likely to offer participant fees which are more comparable to these employers' plans.
    - Limited Internal Benefit/HR Resources – In many cases with carve-outs, limited or no HR/benefits internal resources are acquired during the transaction. This can hinder the carve-out's ability to properly manage a traditional single-employer plan and its associated fiduciary obligations. With a PEP, however, the carve-out may assign much of the retirement plan management to the PEP, which significantly reduces administrative needs and costs and shifts much of the fiduciary responsibility (and risk) to the PEP.
- An Alternative Solution – Rather than assuming/purchasing a retirement plan that has outstanding compliance or litigation concerns upon close, a PEP could be implemented quickly and serve as an alternative solution. As a result, the buyer is not forced to assume a problematic seller's plan simply because of time constraints.

Takeaways

PEPs are intended to lower participant costs, achieve higher levels of efficiency, alleviate the burden of plan administration, and decrease ERISA fiduciary liability when compared to single-employer retirement plans. However, some risk and liability still exist for participating employers in a PEP. Not all PEPs are structured the same way, and it is crucial to understand which risks and liabilities shift to the PEP and which ones remain with the portfolio company as a participating employer.

The decision as to whether to join a PEP requires a prudent decision-making process and a PEP's fees and investments will still need to monitored and benchmarked on an on-going basis. To this end, our benefits consulting group has extensive knowledge of the PEP market and can provide unbiased advice on the different PEP offerings, how they compare to single-employer retirement plans, and which ones may align with the needs of specific portfolio companies.

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