WRITTEN STATEMENT OF KENT MASON

DAVIS & HARMAN LLP

FOR THE

ROUNDTABLE ON

SMALL BUSINESS RETIREMENT POOLING: EXAMINING OPEN MULTIPLE EMPLOYER PLANS

BEFORE THE

SUBCOMMITTEE ON PRIMARY HEALTH AND RETIREMENT SECURITY

OF THE

SENATE COMMITTEE ON HEALTH, EDUCATION, LABOR AND PENSIONS

JUNE 21, 2016

My name is Kent Mason. I am a partner with the law firm of Davis & Harman LLP, and have worked in the retirement savings area for 34 years. I thank Chairman Enzi, Ranking Member Warren, and this Subcommittee for examining the important topic of open multiple employer plans. I appreciate the opportunity to participate in this Roundtable and to provide this written statement. I am providing this testimony on my own behalf based on extensive discussions and work on these issues over the years.

The core issues before us today are (1) expanding the availability of multiple employer plans ("MEPs"), and (2) removing a significant impediment to the adoption of MEPs.

SUMMARY

Expanding the availability of MEPs. Under Department of Labor guidance, all employers participating in a MEP must have a close relationship with each other -- a nexus -- other than participating in the same plan. This has severely limited the universe of small employers that are able to participate in a MEP because so many employers do not have a sufficient nexus with other employers.

The limited availability of MEPs deprives most small employers of the opportunity to band together in a common plan to achieve many of the economies of scale enjoyed by larger companies. As discussed in more detail below, I believe that the nexus requirement should be eliminated in the case of defined contribution plans, as reflected in several leading bills, including multiple bipartisan bills. This would permit what is often referred to as an "open MEP," i.e., a defined contribution MEP that includes unrelated employers.

Removing an impediment to adoption of MEPs. Under current law, if there is a failure to satisfy the tax qualification rules with respect to any employer participating in a MEP, the entire MEP is considered to have failed to satisfy such rules, triggering extremely adverse tax consequences for all the participating employers. This is often referred to as the "one bad apple" rule.

One of the main reasons that small businesses are hesitant about joining a MEP is this one bad apple rule, i.e., the possibility that they could incur substantial tax liabilities due to the actions of another participating employer. The possibility of such a result causes great concern among small risk-averse businesses that cannot afford new and unexpected costs, and do not want to risk their future based on the actions of numerous other companies.

As discussed in more detail below, I believe that the one bad apple rule should be substantially repealed, again as reflected in several leading bills, including multiple bipartisan bills.

BENEFICIAL EFFECTS OF MEPS

Data supporting the beneficial effects of MEPs. There is various data regarding the extent to which small businesses sponsor retirement plans for their employees. But there is widespread agreement on one critical point: small business coverage rates are far too low, which is jeopardizing the retirement security of millions of employees who work for small businesses. The challenge is how to raise this coverage rate.

In written testimony provided last week before the Senate Special Committee on Aging, Catherine Collinson, President of the Transamerica Center for Retirement Studies, offered the following insights, based on survey data:

> Only 27 percent of companies that do not offer a plan say they are likely to begin offering one in the next two years. Among the 73 percent who are not likely to offer a plan, the two most frequently cited reasons are that their company is not big enough (58 percent) and concerns about cost (50 percent). However, in contrast, one in five of them (22 percent) did say they would be likely to consider joining a multiple employer plan offered by a vendor who handles many of the fiduciary and administrative duties at a reasonable cost.

This data provides powerful evidence that this Subcommittee is on exactly the right track in focusing on open MEPs. By making MEPs more available and more workable, it may be possible to cause as many as 22% of the most reluctant employers to adopt a plan.

OPEN MEPS

Strong support for the bipartisan approaches to open MEPs. There has been substantial discussion of the need to permit open MEPs in order to broaden retirement plan coverage. In this regard, the key policy discussion has revolved around how to include sufficient safeguards to protect employers and participants in open MEPs without imposing unnecessary burdens that eliminate the only advantage of MEPs: the cost savings achieved by economies of scale. In this regard, I strongly support the following bills, which are very similar and are generally bipartisan:

- Section 207 of the SAFE Retirement Act of 2013 (S. 1270 from the 113th Congress), introduced by Senate Finance Chairman Hatch (R-UT).
- Section 3 of the Retirement Security Act of 2015 (S. 266), introduced by Senators Collins (R-ME) and Nelson (D-FL)
- Section 201 of the USA Retirement Funds Act (S. 1979 from the 113th Congress) introduced by then Senator Harkin (D-IA) and Senator Brown (D-OH).
- Section 3 of the Retirement Security Act of 2015 (H.R. 557), introduced by Representatives Buchanan (R-FL) and Kind (D-WI) (companion bill to the Collins/Nelson bill).
- Section 17 of the SAVE Act of 2015 (H.R. 4067), introduced by Representatives Kind (D-WI) and Reichert (R-WA).

I was also very pleased that the Administration's budget contained a proposal supporting open MEPs. That proposal did, however, impose far more burdens on open MEPs than any of the bipartisan bills referenced above, and some of the burdens would render open MEPs unusable. However, the point of my statement is to emphasize the widespread bipartisan agreement and to urge all parties to continue to work together to enact a workable bipartisan solution with respect to open MEPs.

In this regard, I offer my views below on the policy background that should be taken into account in framing the bipartisan approach.

Why elimination of the nexus requirement will not create opportunities for abuse. The nexus requirement makes great sense in the health plan area, but does not make policy sense in the context of a defined contribution MEP, as discussed below.

In the health plan area, a critical concern is the possibility that there will be insufficient funds to pay claims. If, for example, a multiple employer health plan is underpriced (either inadvertently or intentionally in abuse cases), the plan will likely have insufficient funds to pay promised claims, which obviously can lead to very adverse results. If a plan is marketed to unrelated employers by an inexperienced or unscrupulous promoter, the potential for this type of result is significant. An inexperienced promoter may price the plan too low out of ignorance; an unscrupulous promoter may price the plan too low to "make a fast dollar," without regard to the long range viability of the plan.

On the other hand, where a group of closely related employers join forces to form and control their own health plan, the potential for these adverse effects is far less, since they have every incentive to price the plan appropriately or even conservatively. A group of closely related employers controlling their own plan is very similar to a single employer maintaining a plan; their sole interest is in a viable, sound plan. Hence, the nexus requirement makes great sense in the health plan area, since it excludes the situations where additional oversight is needed.

In the defined contribution plan area, there is no reason for the nexus requirement because the above adverse results cannot happen. In a defined contribution plan, no participant has any claim to any assets other than the assets actually in his or her account. So by definition in a defined contribution plan, the plan's assets generally cannot be insufficient to pay promised benefits. Without this potential for adverse results, there is no policy justification for the nexus requirement.

One might argue in response that in the defined contribution plan area, there is still potential for the plan to be unable to pay promised benefits, i.e., in the case of fraud or embezzlement of funds. That is certainly true. But it is equally true in the case of a single employer plans. In other words, compare the following two situations. In case A, 1,000 employers join together in a defined contribution MEP. In case B, 1,000 employers maintain single employer plans, and the assets of such plan are held in a group trust administered by the same fiduciary and recordkeeper. In both cases, the money is held in one trust overseen by one fiduciary. The potential for fraud or embezzlement is identical.

In short, there are some who argue that we need to create extensive anti-abuse rules for open MEPs to protect against the problems that have occurred in the health plan area. The two types of plans are not comparable at all, so these arguments cannot withstand scrutiny.

Why not adopt strict requirements on open MEPs to be sure to prevent abuse? If burdensome requirements are applied to open MEPs, this will simply defeat the purpose of the open MEP legislation. In other words, the point of permitting open MEPs is to facilitate a means for small employers to band together to achieve economies of scale and thus reduce the cost of maintaining a plan. If numerous new burdens are added to open MEPs, the cost savings can be more than offset by the extra expense of the new burdens. The result would be open MEP legislation that virtually no one would use.

As noted, in my view, the numerous bills referenced above apply appropriate protections and do not include unnecessary burdens that would make open MEPs unusable.

Preserve "closed" MEPs. All of the bills cited above share another key feature. The additional safeguards applicable to open MEPs do not apply to "closed MEPs," i.e., MEPs that satisfy the nexus requirement. These MEPs exist today, are serving a critical function for their participating employers, and have a great track record of success. Accordingly, the bills preserve the law applicable to closed MEPs without adding any additional requirements that would only add costs and burdens to a system that is working well. This is a very much needed element of any legislation with respect to open MEPs.

Level playing field. The Department of Labor has issued guidance – without public notice and comment -- permitting states to maintain open MEPs in which private employers may participate. It is important for Congress to restore a level playing field here by permitting both state and privately sponsored open MEPs under a uniform set of rules. Without a level playing field, a segment of the market could move away from private providers to a single government provider, thus undercutting price and quality competition and innovation.

ONE BAD APPLE RULE

The one bad apple rule is an overly punitive rule that inhibits adoption of MEPs. If one noncompliant participating employer in a MEP can trigger enormous tax liabilities for all other participating employers, that can understandably prevent employers from participating in a MEP, even if the risk of actual disqualification of the MEP is remote as a practical matter. Fortunately, there is widespread bipartisan agreement that this problem needs to be fixed, as evidenced by the fact that the following bills would prevent the adverse application of the one bad apple rule

- Section 207 of the SAFE Retirement Act of 2013 (S. 1270 from the 113th Congress), introduced by Senate Finance Chairman Hatch (R-UT).
- Section 3 of the Retirement Security Act of 2015 (S. 266), introduced by Senators Collins (R-ME) and Nelson (D-FL)
- Section 3 of the Retirement Security Act of 2015 (H.R. 557), introduced by Representatives Buchanan (R-FL) and Kind (D-WI) (companion bill to the Collins/Nelson bill).
- Section 16 of the SAVE Act of 2015 (H.R. 4067), introduced by Representatives Kind (D-WI) and Reichert (R-WA).
- Section 202 of the Retirement Plan Simplification and Enhancement Act of 2013 (H.R. 2117 from the 113th Congress), introduced by Representative Neal (D-MA).

These bills do vary in one respect. They vary on whether the one bad apple rule should be modified legislatively or administratively through a legislative direction to Treasury to fix the problem. Both approaches are reasonable, and I would support both. However, based on recent discussions with the government and private sector, I would recommend resolving this issue legislatively. The Hatch bill provides an excellent framework for this approach, as it carefully delineates where the one bad apple should and should not apply. Specifically, if the violation of the qualification rules is triggered by the actions or inactions of one or more participating employers, the one bad apple rule should not apply. But if the violation is attributable to the actions of the plan administrator, the one bad apple rule should continue to apply as an incentive

for compliance. We believe that this approach properly balances the need for incentives to comply with the need to avoid punitive sanctions that discourage employers from participating in a MEP.

This relief with respect to the one bad apple rule should apply to both open and closed MEPs, as under the bills referenced above.

ADDITIONAL RELATED ISSUE

New and innovative ideas are being developed to facilitate the adoption of retirement plans by small businesses. Under one new approach, service providers have developed a way to streamline plan administration by establishing a common administrative framework for small business retirement plans. This is achieved by offering retirement plans to small businesses across the country with a common trustee, a common named fiduciary, a common plan administrator, a common set of investment options, and a common recordkeeper. So any small employer participating in this arrangement would have its own plan, but the administrative framework would be the same as the framework for potentially thousands of other small business plans.

Under current law, each of these small business plans must file a separate Form 5500, even though much of the information in every one of the Form 5500s is identical. This is an unnecessary expense, and unfortunately a material expense.

The problem can be easily solved. The Department of Labor and the Treasury Department could be directed to revise the rules regarding Form 5500s to permit a single Form 5500 to be filed by the common plan administrator of defined contribution plans that also have a common named fiduciary, recordkeeper, investment menu, and trustee. DOL and Treasury would be authorized to require such single Form 5500 to contain such information about the separate plans as is necessary or appropriate to ensure that DOL and Treasury do not fail to receive needed information. In short, DOL and Treasury would be directed to eliminate the wasteful duplication that occurs today but without giving up any valuable information.

This proposal is not intended to replace or undermine the above proposals to facilitate wider usage of MEPs. On the contrary, experience with small employers indicates that different small employers may be drawn to different approaches – MEPs or similarly structured single employer plans. Accordingly, this proposal would supplement the MEP proposals by eliminating an unnecessary expense for small employers that pursue the latter approach.

CONCLUSION

I applaud this Subcommittee for holding this Roundtable. We have broad bipartisan agreement on MEP reforms that will materially increase retirement plan coverage among small employers, as evidenced by the survey by the Transamerica Center for Retirement Studies. Several of my clients and I stand ready to do whatever we can to help turn this agreement into enacted legislation. Thank you for the opportunity to present this statement.