McGee, Hearne & Paiz, LLP
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Written Testimony of

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to the
United States Senate Committee on Health, Education, Labor, and Pensions
Subcommittee on Primary Health and Retirement Security

Small Business Retirement Pooling:
Examining Open Multiple Employer Plans

June 21, 2016

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Introduction

Thank you Chairman Enzi, Ranking Member Warren, and members of the committee for the opportunity to participate in today's retirement plan discussion. My name is Jeffrey Stacey. I am the Senior Manager for Employee Benefits with the Cheyenne, WY based accounting firm McGee, Hearne & Paiz, LLP. We are the largest accounting firm in Wyoming. Among the many services we offer to our clients is Third Party Administration (TPA) of employer sponsored retirement plans.

I first started working in the retirement plan industry in my hometown of Nashville, TN 20 years ago administering the retirement plans for one of the Baby Bell telephone companies which had thousands of participants in several different plans. Thirteen years ago I moved to Wyoming to work for McGee, Hearne & Paiz, LLP and have worked with retirement plans ranging from one-participant sole-proprietor plans to a 500-participant retirement plan. During my two decades of experience I have worked with profit sharing plans, 401(k) plans, traditional defined benefit pension plans, cash balance pension plans, executive deferred compensation plans, and cafeteria plans. I am an Enrolled Retirement Plan Agent (ERPA) allowing me to represent clients before the IRS on retirement plan matters. I also hold the following industry designations: Certified Employee Benefits Specialist (CEBS) from the International Foundation of Employee Benefit Plans, Accredited Pension Administrator (APA) and Accredited Pension Representative (APR) from the National Institute of Pension Administrators.

I have often heard retirement funding compared to a three-legged stool: (1) Social Security, (2) employer pension, and (3) personal savings. For the vast majority of today's workforce including me, legs 2 and 3, employer pension and personal savings, are combined. Most employers no longer offer defined benefit pension plans but instead offer defined contribution plans such as a 401(k) plan. Regardless of whether one thinks the slow shift during the last 40 years away from defined benefit plans to defined contribution plans was a good thing for individual Americans and the country as a whole, it is the reality where we find ourselves today. The issue now is how can we encourage Americans to start saving for retirement, maintain their retirement savings when transferring jobs, and increase their retirement savings rate over time.

Retirement Savings Options for Small Businesses

Small businesses such as the ones we serve in Wyoming and the surrounding region often do not have the luxury of a Human Resources Department. The business owner is the HR Department. The owner is an expert at providing their chosen goods and services to their customers. Attracting and retaining employees is often difficult, especially in small communities. This makes a benefits package very important. In addition to running day-to-day operations, the small business person must shop for and build a benefits package. While health insurance has dominated the headlines for many years, saving for retirement is just as important.

Being an accounting firm, our clients will often seek our advice about their savings options for retirement. Some small business owners look at their business itself as their retirement account meaning that they intend to sell the business in the future and use the proceeds to fund their retirement. Others see the need to save in a retirement vehicle where it is protected from bankruptcy. Some see the need for a retirement plan as a necessary employee benefit to not only attract good employees but also to assist their employees with achieving their own retirement goals. Regardless of what prompts our client's questions or what prompts us to bring up the subject with them during a tax planning meeting, a small business owner is almost always interested in a defined contribution plan such as a…

- 401(k) plan
- Profit sharing plan
- SIMPLE IRA
- SEP IRA.

Complexity of Plan Administration

I have yet to meet a small business owner who during our initial discussions had any idea of the complexities, paperwork, and liability of an employer sponsored retirement plan. They just want to save money and taxes as well as offer the same opportunity to their employees. One thing the nation's long health insurance discussion has taught us is that larger businesses usually get better per-person pricing than smaller businesses. This is often true in retirement plans since investment companies usually consider three key factors when pricing their services for a retirement plan:

1. Number of participants
2. Current plan asset value
3. Expected total annual contributions.

A small business that is starting a plan with no assets will usually pay higher fees than a plan with an existing asset base. It many take many years before the assets reach a price breakpoint where fees will decrease. Higher fees translates into a lower annual rate of return and therefore a lower account balance. In addition to fees within the investments themselves, the small business has the expense of accounting fees. Outside of the plan, we charge the plan sponsor for TPA services such as the preparation of an IRS pre-approved plan document and plan compliance services which include discrimination testing, contribution calculations, participant account reconciliation, participant loans and distributions, Form 5500 and potentially numerous other tax forms depending on the plans design and activity during the past year. Most small businesses pay for our TPA services directly as a business expense rather than pay from plan assets which would further reduce the plan's rate of return. Where TPA services are bundled with the recordkeeping services provided by the investment company, the cost is often built into the plan's overall fee structure.

In addition to the difficulty of understanding plan design and compliance, small business owners are bombarded with an ever-growing number of required notifications and disclosures they need to distribute to plan participants. Whether they must distribute notices on paper or can distribute to employees by e-mail, it is another small burden on their time.

Our Experience with an Open Multiple-Employer Retirement Plan

In 2005, our firm was approached by MassMutual with whom we had several mutual retirement plan clients and was asked to consider sponsoring an open multiple-employer 401(k) plan or MEP for our small business clients who could not afford to have a plan of their own. After much consideration and discussion with MassMutual's local investment advisors, we decided to proceed with the opportunity. We viewed it as a simpler option for some of our small business clients and a potentially profitable business opportunity for our firm.

McGee, Hearne & Paiz, LLP is formerly a satellite office of RSM McGladrey, now RSM US LLP. Since becoming independent in 2000, we have maintained a network affiliation with them. As we considered establishing a MEP, we sought RSM's advice on how to proceed. They drafted an individually designed plan document for us and recommended that our firm also have participants in the plan so we would have "skin in the game", so to speak. One of our partners and I became participants in the new MEP, so I have personal experience being a participant in a MEP as well.

Working with the local investment advisors and mining our own extensive client database for appropriate prospects, we marketed the MEP to small businesses in our area. All parties involved expected great results, but ultimately we were only able to add 18 employers to the plan. Listed below are the types of small businesses that joined our MEP:

- Agriculture association
- Bookkeeping
- Commercial printing
- Construction
    - Earthwork
    - Home building (2)
    - General contracting
- Land surveying
- Law firm
- Lobbying
- Plumbing
- Property management
- Retailng
    - Carpet & tile
    - Furniture
    - Pharmacy
    - Photocopier distribution
    - Tires
    - Windows & glass

At its peak, our open MEP covered approximately 150 participants from 18 different unrelated employers. The range of participants is detailed below.

- Sole-proprietors with no other employees 2
- 2 to 10 Participants 9
- 11-20 Participants 5
- 20-30 participants 2

Two features that we did not include in our open MEP and I often do not recommend to clients were automatic enrollment and automatic escalation. While I have seen the statistics demonstrating the benefits of both features, I have also seen the pitfalls that small employers can fall into. Inaction often leads automatically enrolled participants to continue contributing which is a good thing; however many of our small business owners have been concerned about having to deal with the additional work to refund the few participants who might want to opt-out of deferring. Additionally, many of our small business clients want their employees to take some responsibility for making an informed affirmative election. Furthermore, some plan sponsors whose plans may be close to the annual audit participant count could see the plan easily pushed over that threshold by people terminating employment and leaving balances in excess of $5,000 in the plan. Finally, businesses with high turnover can have numerous small account balances that can produce a great deal of additional work for numerous parties.

Automatic escalation of deferrals can be particularly difficult for small businesses to manage. Many small businesses process their payroll in-house. Without a sophisticated system in place, it is very easy to overlook required increases or to override a participant's affirmative election or their previous choice to opt-out of deferring. Such errors result in an additional expense to the small business due to required corrections.

Our MEP was cost-effective for participating employers. We charged the participating employer a one-time setup fee. After that, the participating employers bore no additional direct cost of having a 401(k) plan other than paying employer contributions. Additionally, participating employers had our professional oversight of the plan's operations. Participating employers had an employee benefit that would assist them in attracting and retaining employees. Participants received the benefit of having a retirement plan for the first time with their current employer. Since MassMutual based their charges on total assets, participants experienced lower fees than they would have experienced had their employer sponsored their own stand-alone 401(k) plan. The MEP was a "win" for the participating employers and a "win" for participants, but it was a money losing business for McGee, Hearne & Paiz, LLP.

It was our expectation that the plan assets would grow to be large enough so that the revenue sharing we received would cover our expenses. We expected that having plan assets of at least $10,000,000 would generate sufficient revenue sharing. That growth did not materialize, and plan assets never exceeded $3,000,000. Our firm experienced losses from beginning to end since the time, document, and audit costs far surpassed the revenue sharing we received. With those losses in mind and with the concern that pending regulations at that time could be unfavorable toward

open MEPs, we made the decision to terminate the plan in 2010. The investment advisors worked with each participating employer regarding establishing a SIMPLE IRA or stand-alone 401(k) plan for their business. Listed below are the choices made by our MEP participating employers:

- Adopt 401(k) Plan—6
- Adopt SIMPLE IRA—11
- No retirement plan—0 (one employer went out of business while participating)

Once the plan terminated, the account balance for the two McGee, Hearne & Paiz, LLP participants was transferred to our firms regular 401(k) plan which we still sponsor.

Although our attempt at an open MEP was not successful, subsequent regulations would have made the plan unviable since the participating employers were all unrelated. I believe that open multiple-employer retirement plans can be a viable option for small employers provided that legislation and regulations are such that the plans are easy to understand, inexpensive, and efficient to administer.

State Sponsored Open MEPs

The last several years has seen increasing interest in state capitols in the topic of retirement savings. Specifically, state leaders are interested in ensuring that employees in small businesses have a retirement savings option if their employer does not already offer a retirement plan. Many states are studying their options, and a handful have passed legislation mandating coverage. Many of the proposals I have read about support payroll-deduction IRAs. The current IRA contribution level is $5,500 annually plus a $1,000 annual catch-up contribution for those age 50 and over. Furthermore, recent DOL guidance is tilting the playing field in favor a state-sponsored retirement plans vs. those offered only by the private sector. My personal opinion is that the state mandates will prompt covered small businesses to research their options and move to adopt their own plan instead of participating in their state's plan. This is where an open MEP alternative can be a valuable option for small businesses.

Suggestions for a Private Sector Solution

There are numerous things that can be done to make open multiple-employer 401(k) plans a viable option for small businesses. Many of these recommendations could be applied to stand-alone 401(k) plans to improve them as well.

1. *Allow Open MEPs*—The current opinion of the Department of Labor is that an employment based common nexus or other organizational relationship must be present in order for a true multiple-employer plan to exist. This prohibits nonrelated small businesses from enjoying the benefits of an open MEP. I recommend that employers with fewer than 100 employees be eligible to join an open MEP which is the same employee limit for SIMPLE IRAs. An employer that grows too large for a MEP would have a transition period to transfer out of the MEP to their own stand-alone 401(k) plan. Additionally, a MEP 401(k) would offer participants a

higher contribution ceiling (currently $18,000 + $6,000 catch-up) vs. the above referenced IRA limits or the SIMPLE IRA limits of $12,500 + $3,000 catch-up.

2. *"One Bad Apple Rule"*—This was an ongoing concern for our firm's open MEP that the actions or inactions of one participating employer could have negative repercussions on the entire plan and other innocent participating employers. Each participating employer should be responsible to for only its own participants as well as actions and decisions under its control. We had two major concerns in the day-to-day administration of our MEP: timely enrollment of newly eligible participants and timely submission of employee deferrals and loan payments. To address the enrollment concern, we required the participating employers to provide us with current census data as each enrollment date approached. To address the timely deposit concern, our office submitted the contribution files to the investment company each pay period for each participating employer so we always knew deposits were timely. MassMutual had a sub-plan setup in the MEP for each participating employer. The sub-plan included the business bank account number and routing number for each participating employer. We would submit the contribution file on the plan website and MassMutual would process the debit ACH against the appropriate bank account. Continually contacting employers for their payroll reports as well as preparing and submitting the online contribution files consumed a lot of our time each week.

3. *Model Document*—In order to promote the creation of open MEPs, a model plan document should be created so that service providers can either use the model document or use it as a template for the creation of their own MEP plan document. This could provide certainty and consistency to the service provider community regarding open MEPs.

4. *Higher Annual Plan Audit Participant Count*—Currently, plans that exceed 120 participants as of the first day of the plan year are required to have an audit of the plan for each plan year until the beginning of the year participant count is below 100. A growing MEP will quickly pass that threshold. Our MEP required an audit for 3 of the five plan years in which it existed. The cost of the first audit was paid by the plan. The cost of the audit for the last full plan year and the short final year of the plan were paid by McGee, Hearne & Paiz, LLP which added to our firm's losses from offering the MEP. I recommend that an audit not be required until there are at least 1,000 participants. While I previously recommended that employer eligibility be limited to businesses with fewer than 100 employees, a participating employer's sub-plan may over time have more than 100 participants due to terminated participants keeping their account in the plan. I propose that participating employers with more than 100 participants have a transition period to transfer out of the MEP to their own stand-alone 401(k) plan.

5. *Electronic Delivery of Notices and Disclosures as the Default Delivery Method*—Due to the widespread availability of mobile devices capable of accessing the internet, electronic delivery of required notices and disclosures either via posting on a website or by e-mail should be the default vs. the current default being paper delivery. A participant can be given the option to opt out of electronic delivery in favor of paper delivery.

6. *Modification to Top Heavy Rules*—Current top heavy rules can discourage the initial adoption of a plan, prohibit participation by family members of the business owner(s), and produce a windfall for participants due to an accidental contribution. A 3% top heavy contribution can be due to a non-safe harbor 401(k) plan if anyone who is a key employee either by direct ownership of the business or by family attribution contributes during a top heavy plan year. I recall a plan many years ago where the son of the owner deferred 5% to the plan since he did not know of the top heavy issues. That 5% contribution of approximately $1,300 cost the employer more than $80,000 in unexpected top heavy contributions. In a non-safe harbor plan, the ADP and ACP Tests already restrict contributions by highly compensated employees who in a small business are usually also the key employees or owners. Loosening or eliminating top heavy contributions in an open MEP would encourage more small business participation. It could do the same in a stand-alone 401(k) plan as well.

7. *Expand and Promote the Retirement Savings Contributions Credit*—The comment I most often hear from either newly eligible participants or eligible participants who do not contribute is "I can't afford it." It is my opinion that few know of the credit available for making retirement plan contributions, and it is also my opinion that the credit should be increased from its current phase out levels. A worker filing as single gets a 50% credit if the Adjusted Gross Income (AGI) is below $18,250, and the credit phases out once AGI surpasses $30,500. For a married couple filing jointly, the 50% credit is on AGI up to $36,500 and phases out once AGI surpasses $61,000. Essentially, a person working full-time at an hourly pay rate of about $15 is no longer eligible for the credit. While the credit results in lower *current* income tax revenue, the revenue is not lost. It is *deferred* until the participant taxes a taxable distribution, hopefully in retirement.

8. *Simplicity*—Perhaps one of the most important requirements is simplicity. As mentioned previously, most small business owners are not benefits professionals. They seek advice from others and want to feel like they understand what they are signing up for vs. having no understanding at all. There have been many times when prospective 401(k) plan clients that I have met with have chosen to adopt a SIMPLE IRA instead of a 401(k) plan because there is no plan document to maintain, no annual Form 5500 to file, and the rules are easier to understand. I

believe that an open MEP needs to be easy to understand in order for many small businesses to be willing to consider it as an alternative to meet their needs.

Small businesses hire a TPA like me to help keep them out of trouble. The regulations are too complex for most small business owners to understand while also trying to run their day-to-day operations. Many investment advisors and large recordkeepers like to work with TPAs because people like me help them retain their retirement plan business. In the case of McGee, Hearne & Paiz, LLP, we are a local presence in our community. Many small business people like doing business with other small businesses. In addition to our expertise, we can often have a face-to-face conversation with our clients and can take the time to personally help them deal with situations as they arise. We are not simply a voice on the telephone that they will never meet. Our clients know us, and we know them. I recommend that open MEP legislation preserve a role for local TPAs who can work with small business owners in their community.

Other Suggestions to Streamline Retirement Plan Administration

Many of the suggestions above can be applied to stand-alone qualified retirement plans in addition to being applicable to open MEPs. Listed below are additional suggestions that can be applicable to all qualified retirement plans.

1. *Expanded Self-Correction Opportunities*—Due to the complexity of the regulations and simple human error, administrative errors occur in retirement plans. One of the most common is the late deposit of employee deferrals and loan payments. The Form 5500 requires plan sponsors to report the amount of employee deferrals and loan payments that were deposited late during the plan year. In my experience, this issue more than any other prompts a Department of Labor investigation of a retirement plan. These investigations are lengthy and expensive in terms of both time and money. I recommend that the question be removed from the Form 5500 and that employers be required to self-correct and retain documentation of the correction. Small businesses are often reluctant to make a filing with the DOL and/or IRS when an error occurs due to (1) fear of the agencies, (2) accounting and/or legal fees, and (3) agency filing fees. Many other administrative errors are not required to be reported on the Form 5500, and employers act to make corrections when errors are identified. Removing the reporting requirement for late deposits would be a step toward simplifying compliance.

2. *Seven Business Day Safe Harbor Deposit Window for All Plans*—Plans with less than 100 participants have a 7 business day safe harbor period to timely deposit employee deferrals and loan payments. For larger employers, timely deposit is a facts and circumstances determination based upon the earliest date that the funds can be segregated from the employer's general assets. In reality, the standard for a large employer is the shortest length of time from payday to the deposit date that is

identified during the period being examined. For example, if a two-year timeframe is analyzed and the 401(k) deposit was made on payday even once, the employer is deemed to have demonstrated that it can make the deposit on payday and everything deposited later than payday is deemed late. Large employers should have the same 7 business day safe harbor deposit window as granted to small employers.

3. *Limit 401(k) Loans*—Many employers that I have worked with dislike participant loans due to the extra work they represent and the potential for administrative errors. Despite this, many plans allow loans as an "incentive" for participants so they know they can access funds in a time a need. While a participant's immediate financial need can be satisfied by taking a retirement plan loan, the loan can have unexpected consequences. The opportunity cost of the lost rate of return can be large. Terminating participants often have a short period of time to repay the loan before the unpaid balance becomes taxable income. Some employers can, in my opinion, be too generous by not limiting the number of participant loans. Some employers simply limit the overall dollar amount in order to comply with the IRS limits, but otherwise allow participants to take as many loans as they like. I recommend limiting loans to 1 at a time with no refinancing option available.

4. *Remove the 6-month Deferral Suspension Following Hardship Distributions*—Currently, participants experience a 6-month suspension from making 401(k) deferrals following a hardship distribution. As the term implies, a "hardship" distribution is taken because the participant lacks funds to cover a certain major expense. Many participants face a double penalty since in addition to the missed deferral opportunity they also miss 6 months of employer match in plans that provide a match contribution. Participants who cannot afford to defer for a period of time are free to lower or suspend their deferrals. Those who can afford to continue should be given the opportunity to do so.

5. *Encourage Portability of Accounts*—Although we inform participants of the 10% excise tax on most distributions prior to age 59 ½, many participants cash-out from their former employer's retirement plan when they transition to another job. A distribution from a SIMPLE IRA within the first 2 years of participation results in a 25% unless an exception applies. In my experience, account balances under $10,000 seem to be at the most risk of being cashed-out. I talked to one such participant within the last month who was fired from his job and desperate to have his $1,200 account balance distributed in order to make the next rent payment. While a lengthy discussion can be had about how a person comes to be in that financial situation, I most often see balances under $10,000 used to pay debts, living expenses, or moving expenses. The 10% excise tax acts to discourage premature distributions but people don't have a reward for rollovers. A small refundable tax credit might assist.

Conclusion

Employer sponsored retirement plans are an effective tool for Americans to save for their retirement. Some people I talk with do not expect Social Security to still be there for younger generations. My response to such statements is that I personally expect Social Security to be there when I reach my full retirement age in 21 years; however, I expect there to be reforms to the program to address its long-term financial health and the increasing life expectancy of Americans. Such reforms will probably include an increase in payroll taxes and the Taxable Wage Base as well as increases to the eligibility ages for partial and full benefits. Despite the possibility of future changes to the program, I believe that Social Security will for the foreseeable future maintain its role as the retirement cornerstone of most Americans, but it is not enough. Americans must also save for their own retirement.

A variety of retirement savings vehicles are available. Individuals can save in an IRA. Businesses and non-profits can sponsor a SIMPLE IRA, SEP, or 401(k) plan. Governments can sponsor a 457 plan. Educational institutions and some non-profits can sponsor a 403(b) plan. Additionally, all of these employers can sponsor a defined benefit pension plan if they can afford to do so, but fewer and fewer actively employed private sector employees are covered by such a benefit.

Numerous state governments see a retirement plan coverage gap and are either studying the available alternatives or are actively taking steps to fill the gap. Our federal government should take steps to promote saving through employer sponsored retirement plans. The DOL and IRS provide important oversight and enforcement of the retirement plan sector, but can be inefficient and heavy-handed with well-intentioned small businesses when minor mistakes occur. The intent of regulation and enforcement should be to provide a level playing field and consumer protections for everyone involved in the industry from service providers, to employers, to participants benefitting under a plan. The ever-increasing volume of regulations make compliance difficult and more costly. When I recently provided information to several newly eligible participants in our own accounting firm's 401(k) plan, I provided the following documents.

	Document	Pages
1.	Summary Plan Description	24 pages
2.	Investment Company Enrollment Booklet	50 pages
3.	Section 404(a)(5) Participant Fee Disclosure	9 pages
4.	Safe Harbor Notice	3 pages
5.	Qualified Default Investment Alternative Notice	2 pages
6.	Contribution Election Form	1 page
		89 pages

Fortunately, everyone in our company uses a computer and e-mail as part of their daily duties, so I could deliver these documents via e-mail instead of printing 6 documents totaling 89 pages for each person. Electronic delivery is not an option for many businesses both small and large.

I believe that the vast majority of small business owners across America are just like the ones we serve in Wyoming in that they would like to offer a retirement plan benefit to attract and retain

good employees. More importantly, an employer-sponsored retirement plan can assist the business owner and the employees to prepare for their future. Open MEPs can be another option to help Americans achieve their retirement goals.

Once again, I appreciate the opportunity be a part of this discussion.

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