Getting out of a MEP/PEO/PEP is not as easy as you think.

RETIREMENT MANAGEMENT SERVICES, LLC
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RETIREMENT MANAGEMENT SERVICES, LLC
905 Lily Creek Road Louisville, KY 40243
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Leisha Gosling, MBA, CEBS, QKC, QKA

Multiple Employer Plans (MEP) and Professional Employer Organizations (PEO) have been around for many years. It provides an alternative to single employer plans with several limitations. These plans are adopted by companies that have some commonality such as ownership, same industry or trade, or some sort of common control. SECURE 2.0 expanded on these types of plans by introducing Pooled Employer Plans (PEP). PEPs allow employers with no commonality to participate in a retirement plan that is sponsored by a pooled plan provider. The thought behind these plans is to offer an alternative to single employer plans for small and medium sized employers that in theory will reduce administration cost, spread the fiduciary liability, and provide access to more investments.

While this may be a great option for a few companies, it is not viable for all companies. Plan sponsors need to understand the requirements and costs to cease participation in the MEP/PEO/PEP before committing. A plan sponsor gives up plan design flexibility and the control that allows the plan to be designed to meet the specific goals of a company and their employees, including the ease of changing investment providers, recordkeepers, and plan administrators. Education and resources for plan participants may be limited to an 800 number and a call center for all companies in the MEP/PEO/PEP. The plan sponsor may have limited investment options to offer their participants.

We convert/spin out companies from MEP/PEO/PEP each year and have found several issues with each of these transitions. Most conversions/spin off plans are straight forward and require the company to establish a new plan and cease participation in the MEP/PEO/PEP being careful that there is no overlap in coverage between the two plans. The assets are then transferred from one trust to the other. The newly established plan takes the liability for any mistakes in the MEP/PEO/PEP. Also, this is not a distributable event so participants cannot take a distribution unless they are eligible for one under the MEP/PEO/PEP. This needs to be communicated to set realistic expectations with the participants.

The safe harbor status must follow certain rules. There are restrictions on mid-year changes that should be reviewed carefully in a spin-off. The successor plan rules prohibit plan sponsors from establishing a new plan with safe harbor 401(k) provisions if the same employer previously maintained a safe harbor 401(k) plan in the prior year and the new plan will cover at least 50% of the same employees. Safe harbor plans, by design, must run for a full 12-month period (with limited exceptions). Unfortunately, the IRS has not issued guidance on how plan sponsors can exit a MEP/PEO/PEP with safe harbor provisions mid-year and maintain safe harbor status. Careful consideration and documentation in a newly established plan can be designed to be a continuation of the plan maintained to ensure that the new plan does not violate any of the prohibited changes to a safe harbor plan. Failure to address these issues could result in the plan losing safe harbor status and being subject to ADP/ACP testing and top-heavy contribution requirements, if applicable.

When exiting a PEO plan, plan sponsors should review the service agreements carefully. If the PEO provides HR and payroll services in addition to retirement services, it can cause unexpected outcomes. We have found that PEO companies will end the payroll withholding/reporting services on the date the provider was notified the retirement plan would be spinning out to another provider which was not at all what the company expected. They are surprised by the substantial deconversion fee which covers the expenses incurred by the MEP/PEO/PEP provider in transitioning the participant accounts to a new provider.

If the plan does not have a safe harbor design, the non-discrimination testing is normally completed for two short plan year periods if the spin-off does not occur on the first day of a plan year. Short plan years require proration of both the annual additions limitation under §415(c) and the compensation limit in effect for the year under §401(a)(17). Highly compensated employee determination due to compensation is based on the look-back year. Therefore, a newly established plan effective July 1, 2024 would have a look-back period from July 1, 2023 to June 30, 2024 (rather than January 1, 2023 to December 31, 2023).

Plan sponsors are often surprised to learn that new deferral elections, investment elections, and beneficiary designations will need to be obtained from all the participants in the plan. The deferral elections and beneficiary designations are important because the provisions in the newly established plan may differ from what was offered in the MEP/PEO/PEP. Beneficiary designations are specific to a named retirement plan. Employee communication is key in making this a smooth process.

The key to a successful exit from a MEP/PEO/PEP is having an experienced provider that knows the complexities of moving from a MEP/PEO/PEP to a single employer plan. Please do not hesitate to contact your Account Executive at Retirement Management Services, LLC if you have any questions or concerns.

Retirement Management Services, LLC
905 Lily Creek Road
Louisville, KY 40243

www.consultRMS.com Phone: 502-429-0767