Pooled Employer Plans

The Start of a New Era for Retirement Plans

2020

Empower Results®

Table of Contents

The introduction of defined contribution pooled employer plans (PEPs) shepherds in a new era in US retirement planning.

We have seen the US retirement marketplace evolve over the last 100 years, driven by corporate strategies as well as federal regulations.

What started as informal corporate-sponsored retirement programs transitioned rapidly during WW II to more formal defined benefit plans whose prevalence amongst large firms grew rapidly in subsequent decades.

During the late 20th and early 21st centuries, these plans lost popularity due to the adverse impact that market volatility had on the plans and the financial statements of the companies that sponsored them. During the time of the "defined benefit" plan decline, we saw the next phase of evolution – the introduction of supplemental savings plans (i.e., 401(k) and/or employer-only defined contribution plans) and their ultimate transition to the primary vehicle delivering retirement benefits to employees. These "supplemental" plans rapidly transformed the retirement landscape by shifting the risk of retirement investments to employees and changing the retirement savings paradigm for most Americans.

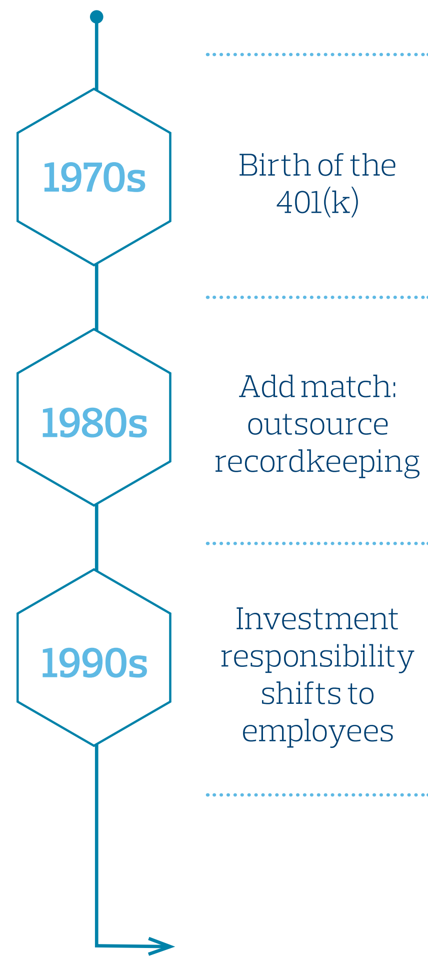
As we get ready for 2021, the next stage of retirement plan evolution is upon us. At Aon, we believe the path of PEPs in the US will follow those seen already in other countries around the world – with Australia/New Zealand notably the furthest along the journey, followed by South Africa and, more recently, the UK and Ireland. It is quite possible there will be very few standalone single-employer defined contribution plans in 20 years – all but replaced by PEPs. Aon believes the PEP can help employers deliver better retirement outcomes to their employees with lower fees, less staff time and involvement, and better fiduciary governance (i.e., less fiduciary risk) – allowing the employer to better focus their energy on running their business and taking care of their people.

History in the Making

The concept of pooled employer plans (PEPs) was created in late 2019 through the passage of the Setting Every Community Up for Retirement Enhancement Act (SECURE Act).

This legislation established a new type of defined contribution (DC) plan effective January 1, 2021. These plans to make it easier for more Americans to save for retirement and not outlive their assets. One of the provisions in this legislation permitted unrelated plan sponsors of DC plans to join PEPs. Previously, plan sponsors could only join together under a Multiple Employer Plan (MEP) if they had some form of commonality (e.g., same industry). In addition, the new legislation protects individual plan sponsors that join PEPs from being jointly and severally liable for issues that arise with other plan sponsors participating in the PEP (i.e., the SECURE legislation protects organizations from the historic “one bad apple” rule).

From the birth of 401(k) plans in 1978, the evolution of DC plans has been influenced by legislation that has guided employers to offer better and more efficient plan benefits. IRC Section 401(k) was created by the Revenue Act of 1978, with many early adopters taking advantage of the new tax preferential treatment and establishing a new type of DC plan: the 401(k) plan. In 1981, IRS regulations allowed 401(k)s to accept employee payroll deductions, and these plans became extremely popular, with many employers choosing to match employee contributions. The growth and popularity of these plans led most companies to outsource the associated recordkeeping services. Subsequent legislation gave employers additional fiduciary protections in offering self-directed investments to employees. These changes paved the way for the universal availability of self-directed investments that we see in defined contribution plans today, with the investment options selected by the employer, as well as the growth of retirement advisory solutions that we see in the marketplace today.



The Economic Growth and Tax Relief Reconciliation Act of 2001 and subsequent legislation enhanced the value of DC plans by creating catch-up contributions and Roth accounts. Innovations such as automatic participation and target date funds became common and increased employee participation as well as investment effectiveness in diversifying portfolios. By this time, 401(k) and employer-only defined contribution plans had replaced pension plans as the main source of employer-provided retirement income for employees.

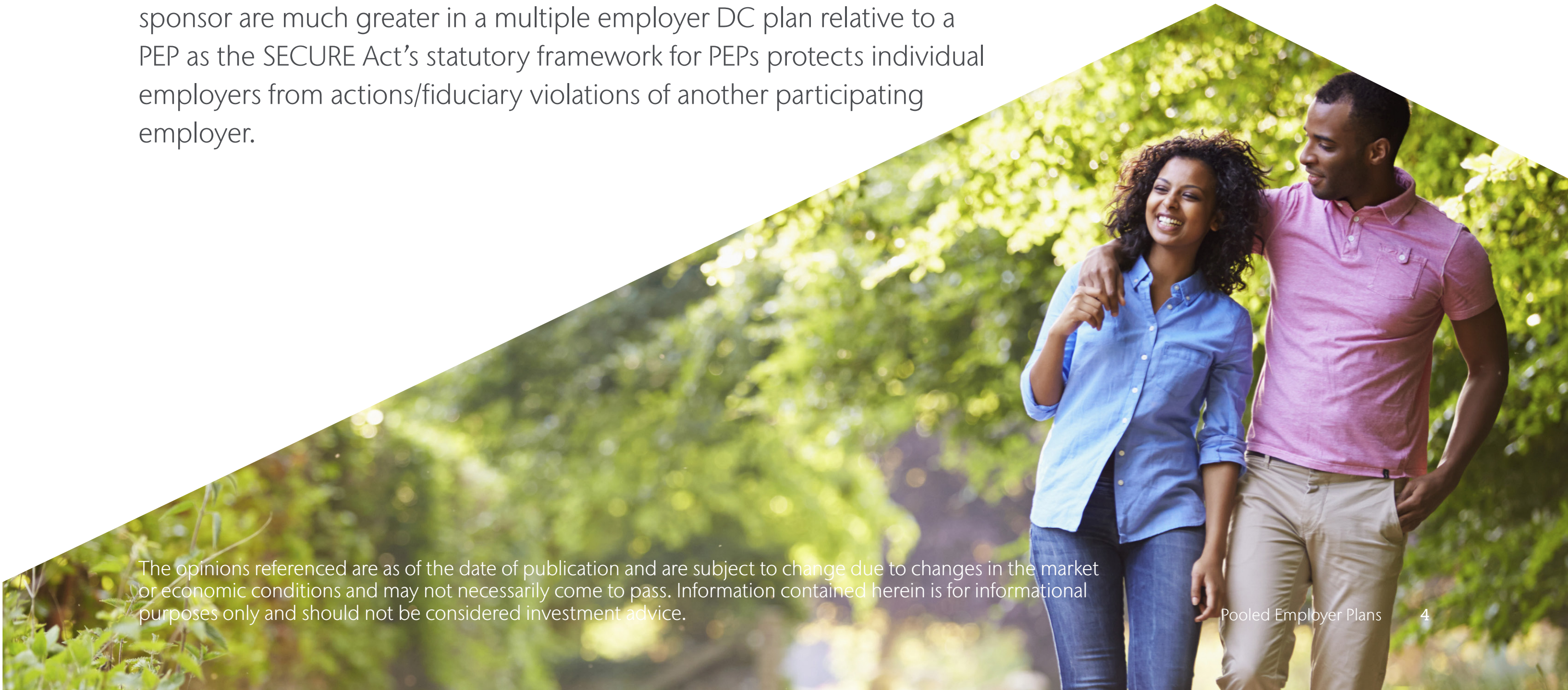
Furthering the spotlight on defined contribution plans, the 2008/2009 financial crisis reduced retirement savings and resulted in increased 401(k) plan litigation, which led to additional participant disclosure requirements in the early 2010s. As the litigation risk continued to rise, and the investment environment grew increasingly complicated, plan sponsors began to explore the outsourcing of their investment responsibilities. The increasing burden of plan governance only added to the reasons to explore different ways of managing risk. To mitigate these risks and implement better governance, many employers accelerated the use of outsourced investment management to external 3(38) advisors. The SECURE Act addresses these two issues by enabling companies to join professionally managed PEPs that assume the fiduciary responsibilities associated with managing defined contribution plans.

Lastly, while multiple employer DC plans have been around for quite some time, these plans had some significant limitations to their popularity. For example, unrelated plan sponsors must have some form of commonality, which limits the number of plan sponsors that are eligible to join such plans. In addition, the risks to the individual plan sponsor are much greater in a multiple employer DC plan relative to a PEP as the SECURE Act's statutory framework for PEPs protects individual employers from actions/fiduciary violations of another participating employer.

2000s — DC becomes more common than DB

2010s — Sponsors outsource responsibility for investments

2020s — Employers join PEPs to outsource DC plan management



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PEPs: A Solution to Retirement Plan Challenges

Many readers may be wondering why this pooled employer arrangement was viewed by regulators as a preferred retirement vehicle to the current single-employer plan.

PEPs are targeted at solving four of the most challenging retirement issues facing plan sponsors and their employees:

Managing complex programs with significant compliance and governance requirements

Delivering diversified and cost-effective investment options, with top-tier managers

Providing first-class customer service at a reasonable cost, along with the tools necessary to help employees make good choices about their retirement

Broaden retirement coverage of the American workforce by allowing for cost-efficient retirement plans which can further provide tools and resources often unavailable to participants of these small plans

While PEPs have some structural similarities to multiple employer DC plans, there are two significant exceptions noted above:

1. No eligibility requirement of commonality of interests (i.e., other than having adopted the plan) for individual plan sponsors
2. Protection from adverse tax and fiduciary consequences associated with actions of other plan sponsors participating in PEP.

Each PEP will be managed by a pooled plan provider (PPP). The PPP will have discretion over plan administration and investments – and will be a named fiduciary of the PEP. The PPP will be responsible for monitoring any third parties that may be hired to deliver services for the PEP (e.g., trustee/custodian, recordkeeper, investment managers) as well as external advisors (e.g., plan auditors).

PEPs will offer some major advantages to sponsors of individual plans:

Lower plan costs resulting from the benefits of larger-scale including recordkeeping and investment management fees

Lesser fiduciary and litigation risks since the PPP will retain virtually all administrative and fiduciary responsibility for operating the PEP

Reduced staff time commitments related to plan management, compliance, and governance (i.e., elimination of many tasks such as government filings, plan audits, etc.)

Improved affordable access to participant tools and services otherwise not available

Improved governance (i.e., overall process, speed to act, breadth of discussion) being developed and executed by professional staff dedicated to operating retirement plans as their full-time occupation

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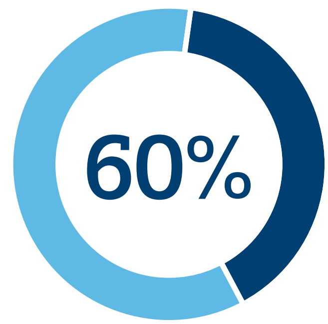
Current Retirement Marketplace

The defined contribution industry has grown significantly over the past twenty years. In 1990 401(k) plans held an estimated $380 billion in assets. Today, that number has surpassed $5.6 trillion.[1]



60% of Americans are worried about running out of money in retirement[2]

As a result, today's current marketplace is now made up of many different players – insurers, recordkeepers, retirement consulting firms, investment managers, trustees, etc. All of these entities are vying for business involving these assets, and with the individual plan sponsors – so buying power is diffused, solutions are variable, and it is very challenging to navigate the market. In addition, the challenging compliance framework and growth of assets makes litigation risk associated with plan investments and related fees a real and ever-growing issue for plan sponsors.

In this market, participants struggle to achieve favorable retirement outcomes. Aon's Real Deal study indicates that the median employee will not be financially ready to retire until age 70. According to Aon's Rob Reiskytl, a primary architect of the Real Deal study, investment fees play a big part in eroding retirement savings -- "reducing costs associated with DC plan investments through careful selection and monitoring plays an enormous role in helping employees achieve their retirement readiness."

Longevity Concerns

Concerns with outliving savings and longevity risk are also prevalent– 60% of Americans are worried about running out of money in retirement, and 80% are looking for some form of guaranteed income in retirement. The evolution from DB to DC plans has put new pressures on employees to manage their savings both before ***and after*** retirement. Lifetime income solutions (e.g., annuities) are still uncommon, offered by fewer than 1 in 10 plans, and can be quite expensive in today's corporate DC retirement plan marketplace. There also exists a huge gap in the "draw-down" advisory support arena, with most of the professional advice focused on the accumulation of assets rather than educating and advising workers on the draw-down of their savings in retirement.

[1] EBRI, History of 401(k) Plans: An Update, 2018

[2] Aon, Living the Dream: DC and Financial Wellbeing Employee Survey, 2018

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Keeping Up with Technology and Cybersecurity Concerns

Cost pressures on recordkeepers have increased as well, leading many providers to focus on outsourcing and/or off-shoring – i.e., leveraging off-shore resources and technology. In addition, the rise of cyber crime has increased pressure on plan sponsors and recordkeepers to ensure systems (and plan assets) are protected against cybersecurity attacks and other fraudulent actions. These competing demands on capital can oftentimes slow down or prevent new innovations and capabilities from being offered in the market, especially to small/mid-size employers. The recordkeeper scale continues to be important in this arena as these competing demands between cost and innovation look to be with us indefinitely.

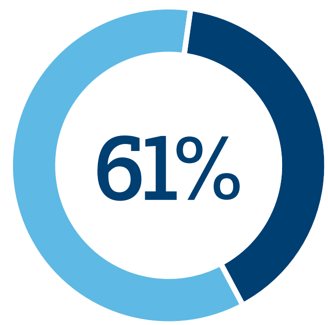
Litigation Concerns

As mentioned above, there have also been dramatic growth in litigation across the retirement market. Litigation has focused on three main areas:

1. Inappropriate investment options
2. Excessive fees
3. Self-dealing in terms of using plan assets to benefit the plan sponsor

Further, the lawsuits have evolved over time, broadening their initial investment focus to broader areas of compliance, investment manager fee structures, and other new areas. This has resulted in plan sponsors having to increasingly focus on tighter governance practices despite being hamstrung by limitations imposed by their administrative vendors. A majority of plan sponsors are more concerned today about fiduciary liability, and, according to a recent Hot Topics in Retirement Survey by Alight Solutions, 61% of respondents believe the threat of plan-related lawsuits is a factor to the organization's ability to deliver new innovations to their plan participants. Growing litigation risk means more emphasis is being placed on plan governance and process documentation, much like the defensive measures being taken by the medical community, these actions can increase ongoing administrative costs and drain the limited corporate resources that are needed to meet this ever-growing compliance burden.

These growing concerns over plan-related litigation risk, along with the complex regulatory burden of ERISA/DOL compliance, make alternative solutions to the current corporate market attractive. What started out in the SECURE ACT as a desire to make available to small/mid-market businesses, more cost-effective retirement solutions seems to be attracting the attention of large plan sponsors as well.

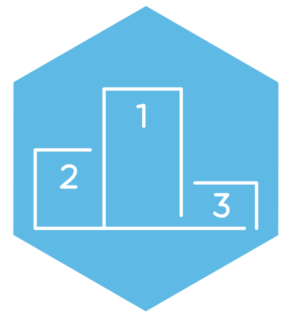


61% of respondents believe the threat of plan-related lawsuits is a factor to the organization's ability to deliver new innovations to their plan participants[3]

[3] Alight Solutions, Hot Topics in Retirement and Financial Wellbeing, 2019

Aon PEP Model

At Aon, we have developed a solution that brings together "best-in-market" defined contribution solutions leveraging Aon's world-class retirement expertise and utilizing the industry-leading recordkeeping capabilities of Voya Financial and Aon Investments 3(38) fiduciary investment management services.



According to Aon's Rick Jones, Senior Partner

"Our overriding objective in forming the Aon PEP was to deliver cost-effective retirement solutions to the corporate DC marketplace – in essence, provide a lower-cost solution that gives employees a better opportunity to achieve their targeted retirement outcomes. We are working to deliver on that promise while also reducing the time commitment needed by corporate HR staff, allowing them to focus on higher-value services that more directly support the business."

Our PEP model includes Aon at the center, operating as the Pooled Plan Provider and named fiduciary. Aon will be responsible for all plan compliance, and oversee all other service providers. We will rely on our retirement plan expertise to provide best practice DC plan design, compliance support, and overall plan management. We have partnered with Voya Financial as our recordkeeper and will rely on Aon Investments USA as the outsourced fiduciary investment manager. Together, we aim to deliver better financial outcomes to employees participating in the PEP as well as provide valuable insights to participating employers as they seek to understand the impact their PEP has on their business and workforce, including recruiting, retention, employee satisfaction, engagement, and career and workforce planning.

Adopting employers joining the PEP will be able to transfer the vast majority of fiduciary obligations as well as ongoing administrative duties to Aon as the Pooled Plan Provider. Employers will still need to retain the fiduciary role associated with 1) Selection of the PEP, and 2) oversight and monitoring of the PEP and its performance.

During the "on-boarding" process, the Aon PEP team will work with employers to transition their existing plan(s) to the Aon PEP. Employers will have the freedom to define the eligible group of their employees as well as the employer contribution level. The employer will also be able to decide, within a set of flexible parameters, design elements such as participation requirements, service definitions, vesting schedule, and the types of automaton desired. All other design elements, such as investment options, type of contributions, loan/withdrawal rules, and distribution options, will be determined by Aon, acting as the Pooled Plan Provider.

Freedom

- Eligible group
- Employer contribution levels, which can vary by group

Flexible

- Participation
- Automation
- Vesting
- Service

Fixed

- Investment choices
- Contribution types
- Loans
- Distribution options

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Future Predictions, Anyone?

The advantages of PEPs seem pretty clear to us at Aon.

We believe PEPs will become the dominant retirement vehicle in the future for companies of all sizes and in virtually all industries – a truly disruptive force in the overall retirement marketplace. The path this takes in the US will likely be different than those paths taken in Australia, New Zealand, South Africa, and the UK (amongst others), but the benefits to employees and employers seem too attractive to think otherwise.

After all, if we were starting all over in defining an employer's role in retirement planning for its employees, would anyone expect the employer to decide anything except the financial contribution they were willing to make and to whom? On a similar note, do employers believe that their employees choose to join or leave a company due to the investment options or other custom design elements of their corporate plan? Lastly, why would any employer willingly choose to accept the added retirement plan cost and burden (on staff as well as company risk exposure) if reliable and efficient alternative solutions were available in the market?

Today's retirement plans need to include best practice features and designs, but we believe PEPs provide the opportunity to do that and also provide the opportunity for employers to fund a competitive retirement benefit for their particular industry or geography. Why not leverage a new way to deliver retirement benefits that can do so at a lower cost, with a reduced compliance burden and overall deliver a better retirement outcome for employees?

Based on this overall value proposition, we predict that over 1/2 of plan sponsors will transition to PEPs over the next 10 years. The benefits of such a move – lower costs, reduced time commitment from corporate staff, improved governance processes and litigation protection, and better retirement outcomes is hard to argue with over time.

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About Aon

Aon plc (NYSE:AON) is a leading global professional services firm providing a broad range of risk, retirement and health solutions. Our 50,000 colleagues in 120 countries empower results for clients by using proprietary data and analytics to deliver insights that reduce volatility and improve performance. For more information, please visit aon.com.

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