

The PEP Opportunity:

A new way to reduce the
retirement coverage gap



The persistent problem of the retirement coverage gap

Workplace savings plans allow workers an easy and effective way to save for retirement, but many are still left out of the employer-sponsored system. For small business workers and their employers, a defined contribution (DC) retirement plan may present the best opportunity to meet retirement goals, but workers who lack access to an employer-sponsored plan must seek out alternative savings options on their own and often, end up not saving anything at all. In 2019, the Setting Every Community Up for Retirement Enhancement (“SECURE”) Act created pooled employer plans, or PEPs— a new retirement savings option to make DC retirement plans more attractive to small businesses. Fidelity believes expanding workplace plans to more workers through PEPs, along with existing retirement savings options, presents the greatest opportunity thus far to fill the coverage gap.¹

¹ Retirement coverage gap is generally defined as U.S. workers who lack access to a workplace retirement savings option. In this piece, the coverage gap is further specified as those without a workplace defined contribution (DC) plan.

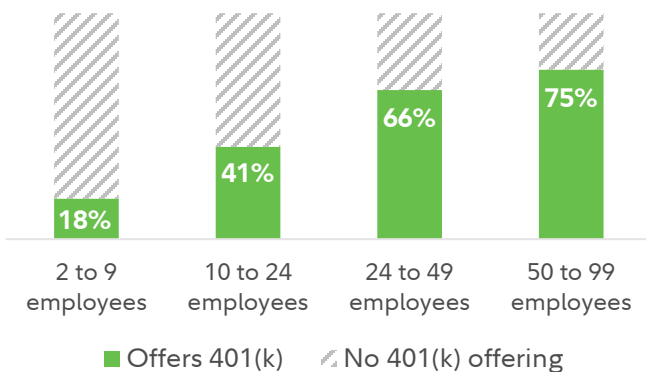


Who falls into the coverage gap?

Small business owners and workers are critical to the U.S. economy and our local communities, yet when it comes to safeguarding their own financial futures, owners and employees have been historically disadvantaged from saving for retirement. In the U.S., workers generally rely on 401(k)s for retirement savings, yet almost half of U.S. employers do not offer workers this benefit, including 70% of small businesses.²

The retirement savings coverage gap especially affects small business employees, and the smaller the company, the less likely they are to offer a retirement plan to employees.

401(k) offering by company size³



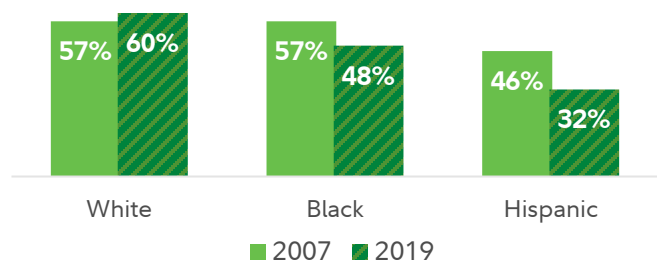
Those who fall within the retirement coverage gap are disproportionately women and underserved communities. Women are more likely to work part-time (or maintain several part-time jobs) than men, often leaving them ineligible to participate in their employer's retirement plan, if one is offered.⁴

A 2020 study from the Employee Benefits Research Institute (EBRI) found that Black and Hispanic families are less likely to work for an

employer with a DC retirement plan than their white working counterparts. As of 2019, only 48% of Black families and 32% of Hispanic families had access to a DC retirement plan through their employer. In contrast, 60% of white families had access to a DC plan.⁵

Perhaps more troubling, is that the percentage of families with a DC plan has not grown over the past decade and a half. In fact, for Black and Hispanic families, it has decreased. As illustrated below, Black and Hispanic families were less likely to have a DC plan in 2019 than they were in 2007.⁵

Access to a workplace defined contribution plan, by race of working family head⁵



² Pew, "Contingent Workers and Barriers to Saving," December 2017.

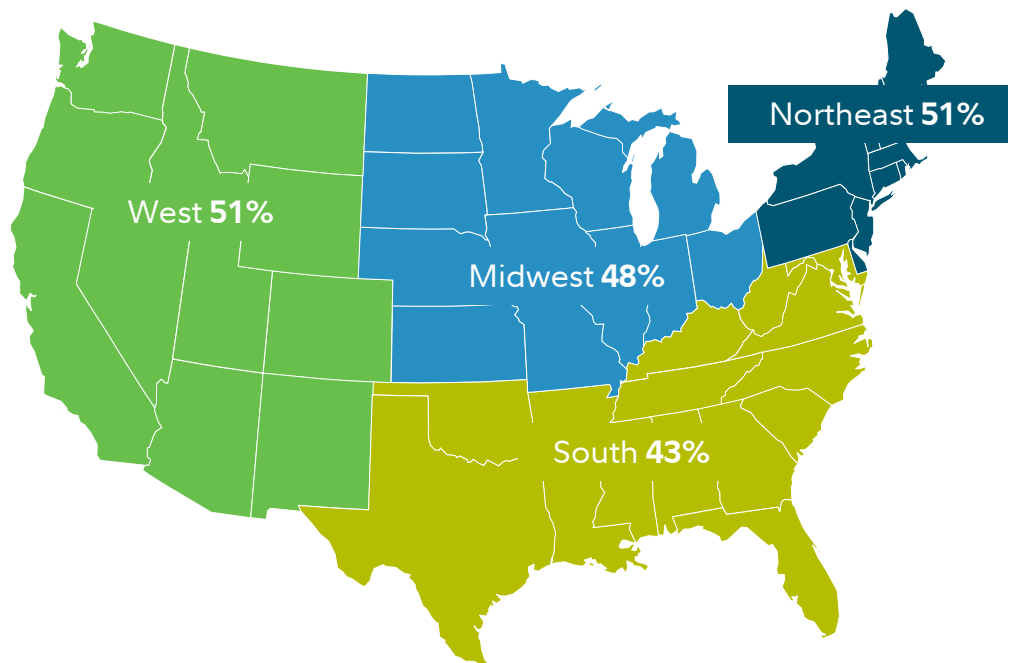
³ Kimberly Landry, "Think Small: Trends in Small Businesses Offering Employee Benefits," Table A2: Benefit Penetration by Size of Firm 2005 - 2018, LIMRA, 2019.

⁴ Tyler Bond, Joelle Saad-Lessler, PhD, and Christian E. Weller, PhD. "Still Shortchanged: An Update on Women's Retirement Preparedness," May 2020.

⁵ Employee Benefits Research Institute, "The Full Picture: Retirement, Financial Wellness, and Health Benefit Considerations of Minorities in the U.S.," "Percentage of Working Family Heads Eligible for a DC Plan, by Race of Family Head," December 2020.

Geographic disparities in access to DC plans⁶

Geographic region also plays a role in access to a DC plan. Workers in the American South are less likely to have access to a DC plan than workers in other areas of the country. Just 43% of companies in the American South offer employees a DC plan compared to 51% of companies in the Northeast and West, and 48% of companies in the Midwest.⁶



Access to a DC plan is critically important. Numerous studies show that access to a workplace retirement plan is critically important for workers to save for retirement throughout their careers because human inertia often prevents workers from taking steps to save on their own. Simply having access to a workplace retirement plan makes a difference in overcoming inertia. The numbers speak for themselves – in general, when offered a retirement plan at work, 79% of employees participate.⁷



Recent Fidelity research shows that enrolling in a workplace retirement plan is linked to better financial decision-making. Employees who have access to a workplace retirement plan and participate reported higher financial confidence and more financial knowledge than their voluntarily unenrolled peers. Further, those enrolled in their employer's retirement plan were 1.5 times as likely to be "motivated to save for the long term" as those who were not enrolled.⁸

⁶ U.S. Bureau of Labor Statistics, National Compensation Survey: <https://www.bls.gov/ncs/ebs/benefits/2018/ownership/private/table01a.htm>

⁷ EBRI, The Full Picture, "Working Family Heads' Participation Rate in an Employment-based DC Plan," December 2020.

⁸ Fidelity's Inclusive Financial Wellness Research online survey of 4,615 employees with access to a 401(k) or 403(b). The survey was conducted by CMI Research on behalf of Fidelity between August 19 to September 23, 2020.

Unique challenges for small businesses offering a DC plan

It is no surprise that small businesses face greater challenges to provide their employees a retirement plan than their larger corporate counterparts.

Offering a quality plan like a 401(k) can be an expensive undertaking—with upfront costs to start a plan, ongoing contributions to the plan, and annual plan and investment fees. But cost is not the only obstacle for smaller companies looking to offer a retirement plan.

Smaller companies generally do not maintain vast administrative and human resources groups, and therefore, often do not have the resources to handle the complex administration and fiduciary obligations of providing a retirement plan.

"It is time consuming and a lot of back and forth with providers. Information can be **confusing and difficult to compare,**" shared one small business owner frustrated with the retirement plan enrollment process.



Source: Internal Fidelity survey of 1,250 of micro and core market retirement plan or other workplace benefits decision makers. Fielded July 20, 2020 to August 5, 2020.

"[There's] too much information that is presented in a complex way. Needs to be simplified," another small business owner suggested.



Source: Internal Fidelity survey of 1,250 of micro and core market retirement plan or other workplace benefits decision makers. Fielded July 20, 2020 to August 5, 2020.

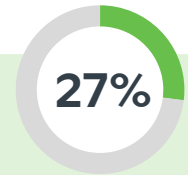
Lastly, many retirement plans including the 401(k) are subject to extensive legal requirements under the Employee Retirement Income Security Act of 1974 (ERISA) and other regulatory obligations. Certain regulatory requirements, such as annual nondiscrimination testing, may discourage smaller employers from maintaining a retirement plan because they face higher risks of not passing such testing.

Unlike larger firms with more administrative resources and larger pools of participating employees, small businesses face an uphill battle to offer a retirement plan and set their employees up for success. But these obstacles also create problems for smaller companies in terms of running the business.

2021 brings new opportunities to reduce the coverage gap

The recent enactment of the bipartisan SECURE Act allows for a new retirement solution aimed to help small businesses and the self-employed.

A hallmark of the SECURE Act was its creation of the “pooled employer plan,” or PEP, which allows multiple unrelated employers to participate in one retirement plan under a single “pooled plan provider,” or PPP. The new PEP model allows smaller employers to overcome many of the obstacles they face today when trying to offer a plan by achieving economies of administrative scale. Fidelity believes giving small businesses greater choice with PEPs will improve retirement coverage.



PEPs could **reduce retirement deficits up to 27%** among workers who would otherwise have spent much of their career ineligible for a DC plan.

Source: Employee Benefits Research Institute, Issue Brief No. 486, July 11, 2019.

What is a PEP?

The SECURE Act allowed the private sector to create a new 401(k)-style retirement vehicle specifically for small businesses called a PEP.

How do PEPs work?

With PEPs, multiple unrelated employers are permitted to participate in a retirement plan with the same retirement provider (the “pooled plan provider”), which allows providers like Fidelity to achieve economies of administrative scale, and therefore reduce employer and participant costs. Essentially, PEPs enable smaller businesses to access the benefits of scale that larger employers can with a traditional 401(k).

How would PEPs help fill the coverage gap?

PEPs help fill the coverage gap by making it easier and more affordable for small businesses and independent workers to offer and/or join retirement savings plans.

PEPs provide more choices, especially for employers that want to offer a DC plan

Businesses are not one size fits all. Neither is saving for retirement. For some employers, it may serve their needs (and the needs of their workforce) to enroll in a state-run IRA program. For others, a SIMPLE IRA plan may be the most appropriate solution. A self-employed business owner may prefer a SEP. Businesses that lack administrative resources often feel constrained to choose an IRA option, as opposed to a DC plan like a 401(k) because the 401(k) requires significantly more fiduciary responsibilities and day-to-day management of the plan.

However, for certain employers, a PEP might not just be another choice but rather, the better choice to help their workforce achieve retirement security while meeting business needs and their workforce strategy. For instance, PEPs offer:

Higher contribution limits – PEPs match traditional 401(k) contribution limits. Employees can defer up to \$19,500 annually, though employees age 50 and older can make “catch up” contributions, totaling up to \$26,000 of salary deferrals each year. PEP and 401(k) employee contribution limits are significantly higher than most IRA options.*

Opportunity for employer contributions – Like 401(k)s, employers in a PEP can choose to offer their employees employer contributions such as matching contributions. Employees with the opportunity to earn a “match” from their employer have even more incentive to save for retirement because their balance will grow faster. Forgoing an employer’s match is akin to leaving money on the table.

Reduced fiduciary obligations – While fiduciary obligations in a PEP are like those in a traditional 401(k), employer members of the PEP can shift most of their fiduciary responsibility to the PPP. In a PEP, the employer benefits from the quality of a 401(k)-style retirement plan, but without the increased oversight.

PEPs

Affordable



Reduced fiduciary & administrative obligation



Optimizes savings rates for owners & employers



*These contribution limits are subject to annual cost of living adjustments.

For employers that feel a DC plan best suits the needs of their business and its employees, PEPs provide additional relief for employers' top concerns—liability and cost.⁹

The many hats of a fiduciary:

- Act prudently
- Act with loyalty for the exclusive benefit of participants and beneficiaries
- Diversify plan investments
- Carry out duties in accordance with the plan's terms and ERISA
- Select and monitor service provider(s)
- Ensure participants (and the plan) are paying reasonable expenses



But that's not all. In a traditional 401(k), employers as plan sponsors, are required to perform numerous functions of the plan. An employer's fiduciary responsibility can increase or decrease based on whether or not certain functions of the plan are outsourced, such as a plan administrator (ERISA 3(16)) or investment manager (ERISA 3(38)). While many larger employers often have the skill, will, and time to handle all of these roles and manage fiduciary responsibilities, employers without these resources can significantly reduce their fiduciary obligations by participating in a PEP. The chart below illustrates the employer's vast responsibilities (including fiduciary responsibilities) in a traditional 401(k) compared to a PEP.

⁹ Internal Fidelity survey of 1,250 of micro and core market retirement plan or other workplace benefits decision makers. Fielded July 20, 2020 to August 5, 2020.

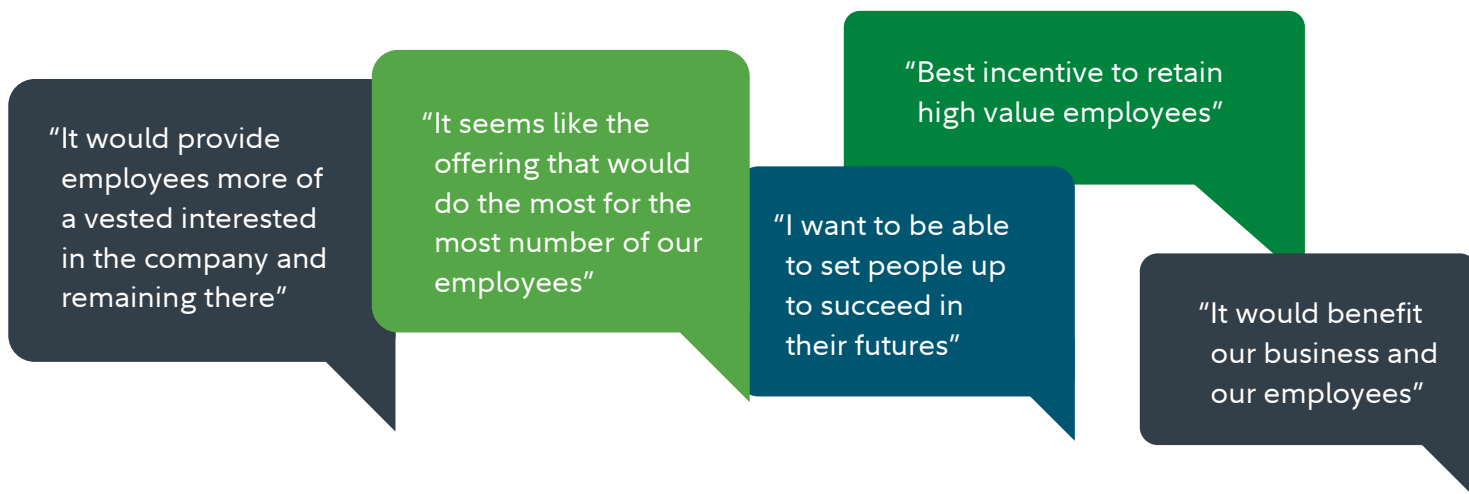
PEPs serve business owners, too

PEPs provide additional choices to save for retirement. For small business owners in particular, PEPs provide a competitive advantage. As small businesses strive to recover from the economic impacts of the pandemic, they face the tightest hiring market in recent history. A record-breaking 42% of business owners reported they cannot fill job openings, according to a March 2021 report from the National Federation of Independent Businesses.¹⁰

As small businesses struggle to compete for talent in the current job market, offering a quality retirement benefit can help distinguish one employer from the lot.

Another benefit business owners see in PEPs is that they are offered by the private sector. Many business owners would prefer to offer their employees a private sector retirement option, rather than one sponsored by the government.¹¹

More choices means more chances to give employees what they need to achieve their retirement goals. But greater choice also helps companies meet their business goals, and business owners reach their own retirement security. When Fidelity asked business owners why they would choose to offer a DC plan to their employees, common responses indicated the advantage would be two-fold: benefiting both employees and business owners.⁹



Small business owners wear many hats and play a unique role as benefits decision-maker, not just for employees, but themselves. As entrepreneurs and small business owners, they too might lack access to the kind of retirement plan they want—the kind that allows them to maximize their savings. In fact, a Fidelity survey

of smaller employers found that the main influence sparking companies' interest in offering a retirement plan came from the business owner, themselves, needing a retirement plan.⁹ Helping owners save for their own retirement in a PEP could increase the likelihood of offering a PEP to their employees.

¹⁰ Small Business Job Openings Hit 48-Year Record High Level in March, National Federation of Independent Businesses, based on 514 respondents surveyed through March 30, 2021.

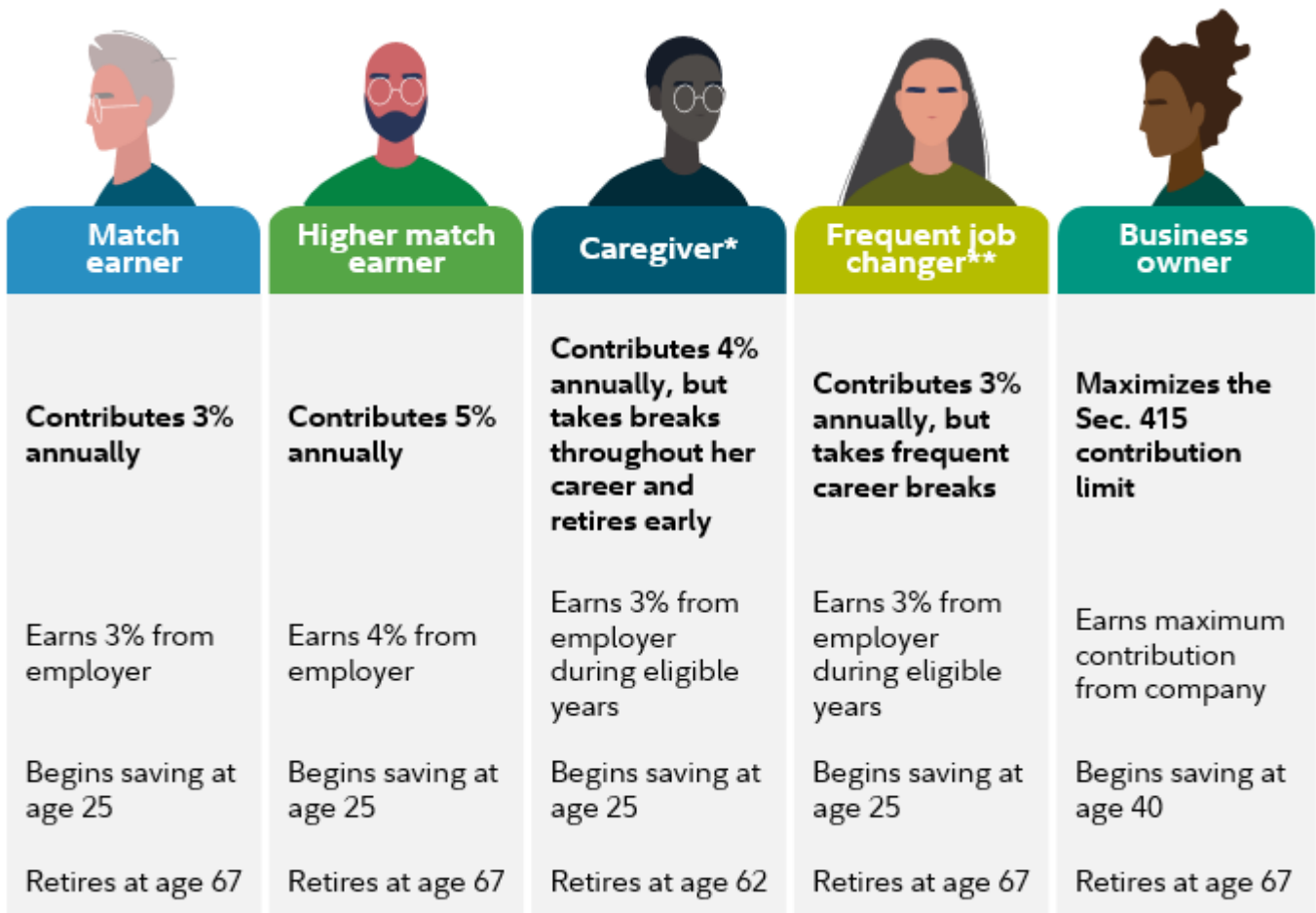
¹¹ Pew Charitable Trusts, Small Business Views on Retirement Savings Plans, January 2017.

Setting workers and business owners up for success

As a leading U.S. retirement and workplace benefits provider, Fidelity understands participant behaviors and employer needs. We have leveraged learnings from traditional 401(k)s and applied them to a new approach to help solve the coverage gap and set all savers up for success.

We believe workers' opportunity to earn an employer contribution is a key component of effectively saving towards a secure retirement. Fidelity's data of existing small market DC plans shows that employees who have the potential to earn an employer match save nearly twice as much than if they were saving on their own.¹²

Fidelity believes that for the right employers, PEPs can set up business owners and employees for retirement better than other solutions in the market. To demonstrate, we evaluated the savings potential of five different worker personas in a PEP over a career:

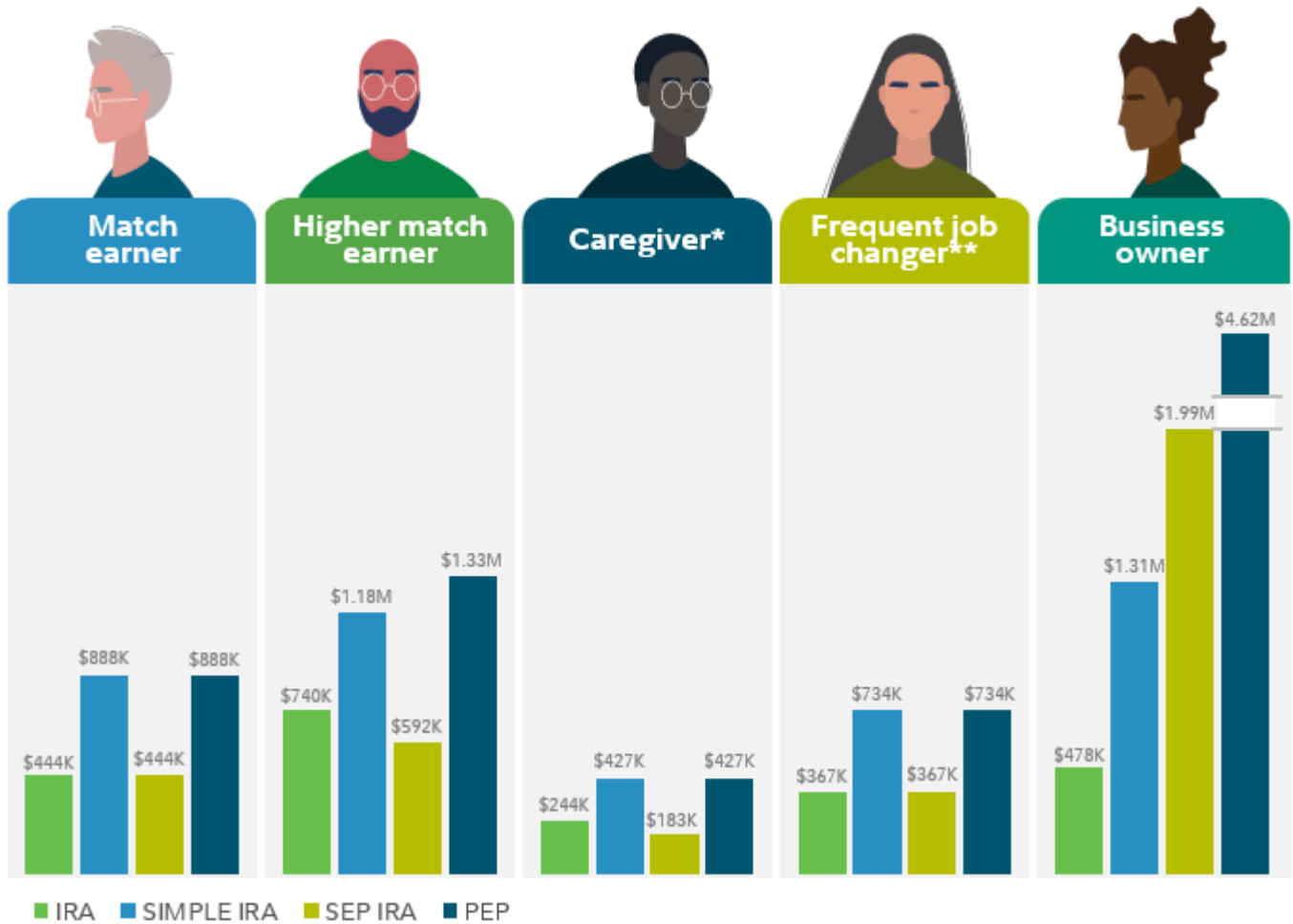


*Caregiver represents employees who weave in and out of the workforce due to caregiving responsibilities such as raising children or caring for aging family members. These employees often have fewer working years, and therefore fewer years to save for retirement.

**According to the U.S. Bureau of Labor & Statistics, the average worker changes jobs over 12 times throughout a career. <https://www.bls.gov/nls/questions-and-answers.htm#anch41>

¹² Fidelity recordkeeping data of 4,000+ small market plans as of January 2021.

For many savers, PEPs can significantly increase retirement balances over the course of their career. To underscore the opportunity PEPs offer, we compared its savings potential to other commonly used savings vehicles for small businesses.



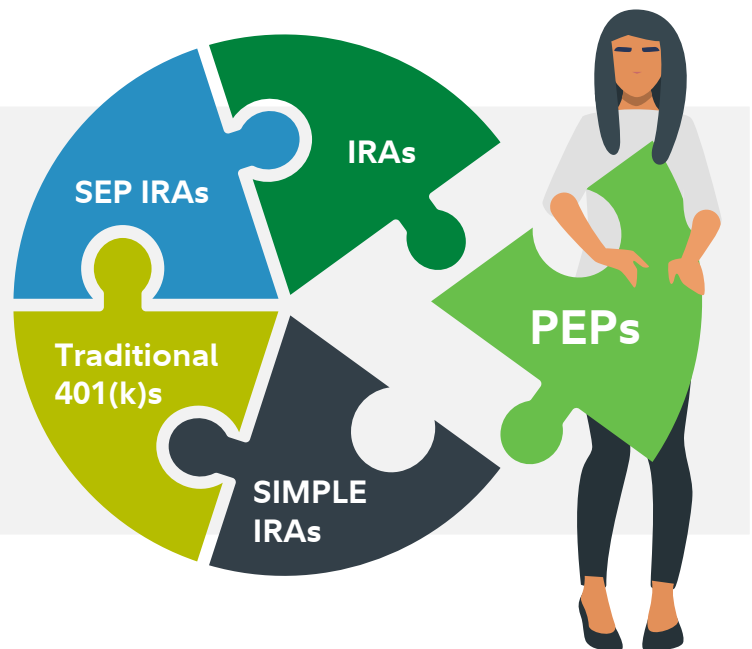
Source: See disclosures at the end of this piece.

- **Among employees**, regularly contributing at least 3% — enough to earn an employer match— can lead to twice the amount of lifetime savings in a PEP compared to most other available savings vehicles.
- **For those struggling to save or entering and exiting the workforce** at different times throughout their career, accumulating retirement assets can be challenging. In these cases, during working years, it is best to save at least enough to earn the employer’s matching contribution.
- **For business owners**, or any employee who can save up to the maximum contribution limit (Sec. 415 limit) for a PEP, they could save approximately \$4.5 million by the time they decide to retire. Keep in mind, here, projections for a “Business Owner” do not begin until age 40, so business owners or others who maximize savings in a PEP prior to age 40 would yield even higher balances by retirement.

Conclusion: PEPs provide the missing piece of the coverage gap puzzle

Small business employees have been left behind in the employer-sponsored retirement system—until now. The SECURE Act's establishment of PEPs allows millions of U.S. workers access to a new quality workplace savings vehicle, a shift Fidelity believes will make a significant difference in reducing the coverage gap. With high contributions limits, competitive investments, and the opportunity for employer contributions such as matching contributions, PEPs provide savings potential beyond some other available retirement vehicles. Further, the creation of the PPP and ability to shift employers' fiduciary responsibilities to the PPP allows employers to enjoy all of the benefits of a traditional 401(k), but now more affordably and with less day-to-day management and risk.

For the first time, smaller employers and their workers, along with the self-employed, have a DC plan within their range of options when saving for retirement.



This hypothetical example illustrates the ending balances accumulated in each savings vehicle, which include traditional IRA, SEP IRA, SIMPLE IRA, and Pooled Employer Plan (PEP). The personas are defined as the following:

1) Match earner: A 25-year-old who makes an annual income of \$60,000, contributes 3% of income annually, qualifying for an employer match of 3%, retires at 67.

2) High match earner: A 25-year-old who makes an annual income of \$60,000 and contributes 5% of income annually, qualifying for an employer match of 4%, retires at 67.

3) Caregiver: A 25-year-old who makes an annual income of \$50,000, contributes 4% of income annually, qualifying for an employer match of 3%, retires at 67. In the hypothetical illustration, caregiver is assumed to take two breaks in their career and stops contributing completely over the duration of the break. First break is assumed to be 5 years, starting at age 28 and ending at 32. Second break starts at age 46 and ends at the end of age 47.

4) Frequent job changer: A 25-year-old who makes an income of \$60,000, contributes 3% of income annually, qualifying for an employer match of 3%. In the hypothetical illustration, frequent job changer is assumed to take three breaks in their career and stops contributing completely over the duration of the break. First break starts at age 30 and ends at the end of age 32; second break starts at age 42 and lasts 1 year; third break starts at age 50 and lasts 1 year, retires at 67.

5) Business owner: A 40-year-old who makes an income of \$100,000, contributes to the maximum allowable limit of each savings vehicle, retires at 67.

This hypothetical example assumes the following: 1) All annual contributions are estimated by multiplying annual income by the contribution percentages selected, taking into consideration the maximum allowable contribution limit of each account. 2) Catch-up contributions at age 50 and older are not factored in the illustration. 3) Employer contribution is only made to the SEP IRA, SIMPLE IRA, and PEP, as traditional IRAs do not allow employer contributions. 4) The hypothetical illustration uses a 7% nominal fixed rate of return throughout the entire duration of accumulation from age 25 (age 40 for business owner) to age 67. 5) No taxes on any earnings applied to the illustration and the ending values do not reflect taxes, or fees. Earnings and pre-tax contributions are subject to taxes when withdrawn. The assumed rate of return used in this illustration is not guaranteed. Investments that have the potential for a 7% annual return also come with risks of loss.

For tax year 2021, the total annual contributions to a traditional IRA cannot exceed \$6,000. For SEP IRA, the maximum allowable contribution is the lesser of \$58,000 and 25% of total annual income. For SIMPLE IRA, the maximum allowable contribution is \$13,500. For PEP, the maximum allowable contribution is \$19,500 for employee. Total employee and employer combined contribution is \$58,000.

For plan sponsor and investment professional use. Approved for use in Advisor and 401(k) markets. Firm review may apply.

Fidelity Brokerage Services LLC, Member NYSE, SIPC 900 Salem Street, Smithfield, RI 02917

© 2021 FMR LLC. All rights reserved.

993642.1.0